

The Failing Firm Defence in EU Merger Control and the Effects of the Economic Crisis on its Development

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<p>Tiivistelmä/Referat – Abstract</p> <p>In the fall of 2013 the European Commission cleared two mergers, <i>Nynas/Shell/Harburg Refinery</i> and <i>Aegean/Olympic II</i>, on the basis of the failing firm defence. Since the European Commission had only twice before accepted a concentration on the basis of this defence these clearances raised the question whether the Commission's interpretation of the failing firm defence had become more lenient. Such a change of practice would have been welcomed both by those who believed that the Commission's failing firm doctrine was too demanding for merging parties to live up to and by European companies that were experiencing financial difficulties in the midst of the economic crisis. However, the European Commission has repeatedly stated that it cannot relax its application of EU merger control rules and that social concerns such as employment should be tackled by instruments designed specifically for them.</p> <p>This thesis assesses the development of the failing firm doctrine of the European Commission. The aim is to clarify how the Commission has reviewed failing firm arguments invoked by the merging parties and whether the decisions adopted during the recent economic crisis have affected this assessment. The thesis has a doctrinal standpoint as it attempts to explain how the European Commission has been and now is applying the failing firm defence.</p> <p>The failing firm defence is invoked when a concentration has anti-competitive effects but one of the parties to the transaction is in financial ruins and would be forced to exit the market without the merger. Competition authorities accept such arguments only when they assess that the merger is more favourable than the exit of the failing company and its assets from the market. It is argued here, that the European Commission has been fairly consistent with its application of the failing firm defence. Ever since clearing a concentration for the first time on the basis of the defence in <i>Kali and Salz</i> the Commission has insisted that the defence can be accepted only if the concentration in question is not causing the deterioration of the competitive structure. The purpose of the failing firm criteria it has established is to assist in the assessment of this causality. However, the 2013 clearance decisions seem to have changed the way in which the failing <i>division</i> defence, where only a business branch or a subsidiary of a financially healthy parent company is failing, is assessed in EU merger control. According to the Commission's initial approach such a transaction could not take place only due to unfulfilled expectations of the parent company. However, both in <i>Nynas/Shell/Harburg Refinery</i> and <i>Aegean/Olympic II</i> the Commission assessed the strategic interests of the parent companies to continue funding their subsidiaries, which it had not done in its previous decisions.</p> <p>The thesis also has a theoretical aspect to it. Competition law has an inherent <i>law and economics</i> approach which is followed here as a series of economic theories concerning merger control is introduced. These theories serve a purpose in educating the reader about the basic concepts relating to the appraisal of failing firm arguments. However, they are also used here for assessing how the European Commission's failing firm doctrine has developed. It is argued here that the acceptance of the defence in <i>Kali and Salz</i> and in <i>BASF/Eurodiol/Pantochim</i> is compatible with the theory of contestable markets as the clearances were followed by <i>de facto</i> monopoly market structures. Similarly in the 2013 clearance decisions the Commission seems to have taken due notice of the theory as the parent companies were allowed to exit unprofitable markets. However, the Commission has not relied on such reasoning every time it has faced failing firm arguments as its initial approach towards failing division arguments illustrates. Instead it can be argued that both the Commission's failing firm doctrine as well as EU merger control on a more general level have been and still are influenced by a variety of partly contradicting economic theories.</p>		
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1. Introduction

1.1. Economic Crisis, EU Merger Control and the Failing Firm Defence

The 2008 financial crisis and the subsequent economic recession have affected the European Union (EU) in a number of ways. Besides staggering economic growth, rising unemployment and harsh austerity measures that have affected many of the Member States, EU law has also been affected by the crisis.¹ On the field of EU competition law the impact of the crisis on the interpretation of state aid rules has been widely discussed.² The effects of the crisis on other sectors of EU competition law, such as merger control practiced by the European Commission, have not been covered as broadly.³

However, predictions concerning the likely effects the crisis might have on merger control have been presented. Economic downturn is expected to cause financial difficulties to companies. The firms that are distressed the most might have to seek refuge by merging with healthier competitors. Therefore during an economic crisis competition authorities – including the European Commission – are expected to face more merger cases where the other party of the transaction is a failing firm. Moreover competition authorities are expected to face more cases in which the merging parties invoke the failing of the target company as a reason to approve their transaction.⁴ In merger control this is known as the *failing firm defence*.

According to Article 2(3) of the Merger Regulation, a merger “which would significantly impede effective competition, in the common market or in a substantial part of it...shall be declared incompatible with the common market”.⁵ Unlike antitrust enforcement EU merger control is practiced on an *ex ante* basis as the European Commission assesses mergers and acquisitions – or *concentrations* – before they take place in order to assure that those

¹ For instance the compatibility of the *ad hoc* solutions – that later gained more institutionalised structures – which the Member States belonging to the Eurozone had to come up with in order to reassure the markets about the stability of the single currency, with EU law has been debated. See e.g. Craig (2013), p. 457–517.

² During the financial meltdown some of the major European banks were on the verge of bankruptcy. The Member States wished to avoid the bankruptcies since the effects were estimated to be catastrophic. However, the decisions to finance and save the banks were controversial in relation to state aid rules of the EU. See e.g. Nordström (2015).

³ One noticeable feature in EU merger control has been the lower number of mergers notified to the Commission following the economic downturn. The number of notifications came down by 35 per cent in 2009 from 2007. During the years 2010–2014 the amount of notifications still did not reach the levels of the pre-crisis years 2005–2008. See European Commission website, *Merger Control Statistics*, <http://ec.europa.eu/competition/mergers/statistics.pdf>.

⁴ OECD (2009), p. 11. See also Malinauskaite (2012) according to whom an economic crisis is a “golden era” for rescue mergers, p. 308.

⁵ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, Official Journal L 24, 29.1.2004, p. 1–22 (hereafter Merger Regulation).

transactions that might be harmful to economic efficiency and consumer welfare are prohibited.⁶ However, the overwhelming majority of mergers are considered to be unproblematic and they are therefore cleared by the Commission.⁷

The failing firm defence brings an exception to the underlying logic of merger control, as mergers that have anti-competitive effects can be cleared on the basis of the defence. The logic behind this, according to the Horizontal Merger Guidelines of the European Commission, is that “the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger”.⁸ Therefore, in situations where competition is going to deteriorate regardless of the merger, the transaction should not be held responsible for the “significant impediment to effective competition”.⁹ In other words, although anti-competitive effects are to follow the merger, they would also occur in the absence of transaction, which is why the approval of the defence is compatible with the substantive test of EU merger control.

The first case in which the European Commission accepted a merger on the basis of the failing firm defence was *Kali and Salz*¹⁰ in late 1993 – a decision which the Court of Justice (ECJ) subsequently confirmed to be correct.¹¹ The failing firm doctrine was further developed by the Commission’s decision in *BASF/Pantochim/Eurodiol*¹² and it is now codified in the Horizontal Merger Guidelines.¹³ However, after these cases the Commission was reluctant to approve the defence although some merging parties did try to persuade it to do so. This led some commentators to believe that the criteria set up for the approval of the defence was too demanding and should be eased at least during the economic downturn in order to avoid bankruptcies.¹⁴ The Commission replied to these comments by stating that it will not loosen its interpretation of the existing rules during the

⁶ In this thesis “merger” is applied as a broader concept covering also “acquisitions” although the two are differentiated when seen appropriate. The Merger Regulation refers to mergers as “concentrations” and the term covers both mergers and acquisitions regardless of the means of the transaction as explained in Article 3(1) of the Merger Regulation.

⁷ In fact, in general mergers are seen to benefit the efficiency and competitiveness of firms. See e.g. Recital 4 of the Merger Regulation.

⁸ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Official Journal C 031, 5.2.2004, p. 5–18 (hereafter Horizontal Merger Guidelines), para. 89.

⁹ See e.g. Bouckaert & Kort (2014), p. 436–437.

¹⁰ Case IV/M.308 *Kali+Salz/MDK/Treuhaund*, Commission Decision of 14 December 1993.

¹¹ I.e. the failing firm defence was compatible with EU merger control rules. Judgment of the ECJ in joined Cases C-68/94 and C-30/95, *France and others v Commission*, EU:C:1998:148.

¹² Case M.2314 *BASF/Eurodiol/Pantochim*, Commission Decision of 11 July 2001.

¹³ Horizontal Merger Guidelines, paras. 89–91.

¹⁴ E.g. Malinauskaite (2012), p. 308; Kokkoris (2014), p. 44.

crisis and that the current Merger Regulation offers enough flexibility to take into account the evolving market conditions.¹⁵

However, in 2013 the Commission cleared two acquisitions, *Nynas/Shell*¹⁶ and *Aegean/Olympic II*¹⁷, on the basis of the failing firm defence. These clearances raised the question whether the Commission had become more lenient in its approach in order to avoid bankruptcies, and the negative social impacts resulting from them. The initial assessments, however, seemed to suggest otherwise as the two cases were estimated fulfilling the demanding criteria that the Commission had previously set for accepting the defence.¹⁸

1.2. Purpose of the Research

This thesis takes a closer look at the development of the failing firm defence in EU merger control. By looking at *how the European Commission has responded to mergers where the failing firm defence has been invoked* the aim here is to *clarify the failing firm doctrine* applied by the Commission.

As already mentioned, after a long period of time, during the recent economic crisis, the European Commission came to accept two mergers on the basis of this defence. Hence, it shall be assessed *how these latest cases have affected the failing firm defence doctrine* established by the Commission in its previous decisions.¹⁹ It is of particular interest to find out whether the Commission has been able to maintain its earlier interpretation of the merger control rules during the economic crisis, or have the new cases introduced changes to the assessment of the failing firm defence possibly in the form of leniency as demanded by some critics. As the both 2013 cases included elements of the failing *division* defence, on the basis of which the Commission has not previously accepted mergers, the purpose of this thesis is also to assess *whether the European Commission's application of the failing division defence has changed* and become more lenient.

¹⁵ European Commission website, *Tackling the financial crisis*, http://ec.europa.eu/competition/recovery/financial_sector.html.

¹⁶ Case M.6360 *Nynas/Shell/Harburg Refinery*, Commission Decision of 2 September 2013.

¹⁷ Case M.6796 *Aegean/Olympic II*, Commission Decision of 9 October 2013.

¹⁸ E.g. Pouncey et al. (2014), p. 25; Perpiñà (2015), p. 104. See also Komninos & Jeram (2014) according to whom the approval of these cases during such a short period of time was more likely to be a coincidence than a reflection of the Commission's changed interpretation of the defence, p. 613.

¹⁹ However, in order to recognise the possible changes brought by the Commission's recent decisional practice, it is essential to look at the development of the failing firm defence in EU merger control in its entirety.

It has been suggested that EU competition law is not serving a purpose of its own but should rather be understood as a tool that is used to accomplish other goals of European Union such as *market integration*.²⁰ Moreover, *industrial policy considerations* are said to have at times gained the upper hand over EU competition law goals.²¹ Against this background, would it not be possible for the European Commission to take into consideration the grim economic development of some Member States and allow this to affect its decision when assessing mergers and the approval of failing firm defence? Therefore I intend to estimate *whether the European Commission has taken other factors besides competition* – such as the negative impacts of the economic crisis or the furthering of industrial policy – *into account in its decisions regarding the failing firm defence*.

The approval of *Nynas/Shell* and *Aegean/Olympic II* doubled the amount of mergers that the European Commission has accepted on basis of the failing firm defence. Hence, there is reason to believe that these clearances also offer insights on questions concerning the interpretation of the failing firm defence that competition law scholars have been speculating about after *Kali and Salz* and *BASF/Pantochim/Eurodiol* decisions. One of the major academic debates has regarded the question *whether it is necessary, in order for the European Commission to approve a concentration on the basis of the failing firm defence, to fulfil the formal failing firm criteria*, i.e. the criteria now listed in paragraph 90 of the Horizontal Merger Guidelines.²² It has been suggested that the Commission might be willing to clear a merger solely on the basis of a *lack of causality* between the merger and the deterioration of competition, as the concentration is not seen to cause more harm to competition than its prohibition would.²³

On a more general level, I wish to look at the development of the European Commission's merger control practice including its approach towards the failing firm defence in comparison with theoretical underpinnings concerning competition law, merger control, and the failing firm defence. Has the Commission been eager to amend its approach along

²⁰ See e.g. Ma (2014), p. 94–95. The competition law provisions of the European Community were originally designed to further market integration by eradicating trade barriers between the Member States. Geradin et al. (2012), p. 16.

²¹ Commission decisions have not always been based purely on the competitiveness of the markets but rather on the survival of European companies against their global competitors. See e.g. Geradin & Girgenson (2012).

²² “First, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Second, there is no less anti-competitive alternative purchase than the notified merger. Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market”.

²³ See Oinonen (2013).

with the development of economic theories or has there been a single dominant theory that has been followed throughout the years?

1.3. Concerning Theory, Method and Material

The research questions posed above cover a somewhat broad spectrum of topics varying from specific changes introduced lately in the midst of the current crisis to overall assessments concerning the development of EU merger control. Hence, I believe that answering these questions requires a broad approach. Methodological *pluralism* is no oddity in legal research.²⁴ In fact, it could be suggested that a combination of approaches offers a comprehensive look at the development of the failing firm defence in EU merger control.

However, the underlying approach is set upon a firm basis of *law and economics* as is common in competition law.²⁵ Economic theories will form the theoretical framework that is applied in order to assess the logic, consistency and successfulness of EU merger control. This is necessary as in the assessment of competition law cases legal deliberation is affected by economic analysis of the circumstances regarding competition in the situation in question.²⁶ In order to understand the economic reasoning used by the European Commission in its decisions concerning the failing firm defence, it is essential to grasp at least the basics of economic theory concerning merger control. As *Seitz* points out, the terminology of competition law includes a range of concepts that have their origin in economics. These terms are vital in understanding the framework consisting of competition law provisions and cases.²⁷

A major purpose of this research is to clarify how the European Commission currently assesses the failing firm defence. As we are defining the legislation in force we are dealing with *doctrinal* research. According to *Hirvonen*, in addition to defining the contents of legal provisions in force, doctrinal research sets forth statements concerning the interpretation of these provisions and strives to improve our comprehension of them.²⁸ This research intends to clarify how the latest cases have contributed to the assessment of the

²⁴ Hirvonen (2011), p. 9.

²⁵ The use of economic analysis in legal research increased in the 1960's as it expanded to more traditional areas of law but economics was applied in competition law even before this. Posner (2003), p. 23.

²⁶ Ojala (2011), p. 10.

²⁷ Seitz (2014), p. 368.

²⁸ Hirvonen (2011), p. 22, 34.

failing firm defence in the merger control practiced by the European Commission. The aim is to present new findings concerning this particular area of law.²⁹

It should be noted that doctrinal research is increasingly expected to use pluralist methodology as legal provisions are recognised to be connected to social, economic, and cultural surroundings.³⁰ This research includes a *comparative law* element, as the development and interpretation of the failing firm defence in the EU is at times compared to the development in the United States, where the failing firm defence had its origins. Similarly, the fact that the historic development of EU merger control and the failing firm doctrine is included means that there is also a degree of *legal historical* perspective to the research.³¹

Doctrinal research is generally carried out by collecting and analysing the relevant case law and legislation which are regarded as primary sources.³² This is also the case with this research although the most important primary sources consist of the decisions of the European Commission in merger cases. Case law of the Court of Justice of the European Union concerning EU merger control rules is also included. The Merger Regulation and the competition law articles in the Treaty for the Functioning of The European Union³³ (TFEU) contain the most important legal provisions but in EU competition law the failing firm defence is dealt within the Horizontal Merger Guidelines which demonstrates that non-regulatory instruments will also play a role as primary sources in this research. The secondary sources primarily consist of competition law handbooks, journal articles dealing with the failing firm defence, and case commentaries concerning the merger decisions of the European Commission.

1.4. Structure of the Research

This thesis consists of five chapters. After the introduction (Chapter 1), we shall turn our attention towards the economic theories that are related to competition law and merger control. The objective of Chapter 2 is to give a general impression of the theories that have

²⁹ Hirvonen (2011), p. 18; Häyhä (1997), p. 19.

³⁰ Hirvonen (2011), p. 55.

³¹ According to Kangas (1997), this inclusion is necessary when dealing with doctrinal research as he argues that when interpreting the legislation in force, the research would not be complete without a historical perspective, p. 92.

³² Dobinson & Johns (2007), p. 19.

³³ Consolidated version of the Treaty on the Functioning of the European Union, Official Journal C 326/49, 26.10.2012, p. 47–390 (hereafter TFEU).

been – and still are – influencing competition law systems including merger control practices. The idea is to ensure that the reader becomes familiar with competition law terminology and is offered the necessary background information that is required for understanding the reasoning of the European Commission in its decisions regarding the failing firm defence. The theories are also used to assess the Commission's approach towards the defence and merger control in general.

Chapter 3 focuses on the merger control practice of the European Union. A historic look at the development and an outline of the goals of EU merger control shall be presented. These sections are relevant for establishing how social and economic realities have shaped EU merger control in the past, and for evaluating the readiness of the Commission to take into account other factors besides competition including the economic crisis. Chapter 3 also offers a general representation of the procedure and substantive appraisal of concentrations under the Merger Regulation. Both of these sections are necessary in order to understand the detailed analysis in the Commission's decisions concerning the failing firm defence discussed in the final chapters.

Chapter 4 is dedicated to the development of the failing firm defence in EU merger control. This begins with a look at the origins of the defence in the United States and the following academic debate concerning its correct application. After this a thorough study of the different decisions adopted by the Commission regarding the failing firm defence – both before and after the economic crisis – shall be presented. This development is analysed by the tools gathered in Chapter 2 and reflected against the merger control practice of the European Commission discussed in Chapter 3. Finally, in Chapter 5 the central findings of this thesis are summarised.

2. Economic Theories concerning Competition

As already noted above competition law includes the use of a number of economic concepts. The close relationship with economics requires us to take a closer look behind the theories used in competition law and competition policy so that we are able to understand the reasoning behind competition law provisions and their application discussed in the following Chapters. Moreover, the theories are used to assess the Commission's approach towards the failing firm defence as well as merger control in general. The economic theories commonly associated with competition are presented here by using competition law literature.³⁴

The role of economics in competition law has grown stronger over time. When antitrust legislation was originally drafted in the United States the approach was more legalistic. However, there economic thinking started to influence competition law from the 1950's onwards while in Europe this did not largely take place until the 1990's.³⁵ During the last decades this influence has been the more visible than ever before in competition law enforcement.³⁶

2.1. Neoclassical Economics and Market Structures Models

Neoclassical economics is the prevailing school of thought in economics.³⁷ This is also evident in the field of competition law, which is heavily influenced by neoclassical thinking and its market structure models. The reason why this might be is the ability of these models to express the effects of competition (or lack of it) on social welfare. However, these models are not well-suited to describe actual existing market conditions, and they are unable to produce clear policy recommendations or instructions on when competition authorities should intervene in the market.³⁸ Nevertheless, they are valuable in explaining the effects competition has in the markets, but their apparent simplicity should be kept in mind.

³⁴ It should be noted that many of the economic concepts and theories introduced here were originated in the field of economics. However, given the scope of this research, competition law literature is considered to offer sufficient depth as source material while introducing these theories.

³⁵ This Chapter is not dealing with EU law but competition law in general. However, occasional references to relevant rules concerning EU competition law and merger control are made when seen necessary.

³⁶ Whish & Bailey (2012), p. 2; Geradin et al. (2012), p. 60.

³⁷ See e.g. Ojala (2011), p. 10.

³⁸ Geradin et al. (2012), p. 62, 69.

2.1.1. Companies have varying degrees of Market Power

Our study of neoclassical economics begins with market power, which is not a market structure, but it is central in understanding the models of perfect competition, monopoly, and oligopoly as well as competition law in general.

Market power is usually defined as the power to raise price above the competitive level.³⁹ This competitive price level is also known as *marginal cost*, which describes the cost of producing the last unit of output (including a sufficient profit margin).⁴⁰ According to neoclassical economic theory's model of *perfect competition*, market price should equal marginal cost.⁴¹ However, when a company possesses market power, it can lift prices above its marginal cost, e.g. by cutting down production, and in this way obtain *monopoly profits*.⁴²

When a company exercises market power, a welfare loss occurs: not all of those who are willing to buy the product can obtain it.⁴³ In addition, the ones who are able to buy the product have to pay a higher price than they would if the market was competitive. From the point of view of economic theory, this leads to suboptimal or *inefficient* allocation of resources in the economy. Abusive market power does not only harm consumers in the form of higher prices and scarcity of products. It can also stall innovation and reduce the quality and the variety of products.⁴⁴ In other words, the resources that should be in the use of consumers or invested in research and development are transferred to the producer in the form of monopoly profits.

In reality, neither perfect competition nor total monopoly describe the actual market conditions. Companies have different degrees of market power, and it should be noted that its possession in itself is not harmful. Market power is usually obtained legitimately by providing consumers better products at a lower price than competitors: companies often gain market power while increasing consumer welfare. This is why competition policy does not prohibit companies from gaining market power but is focused on how market power is obtained, maintained, increased, and exercised. Market power becomes

³⁹ See e.g. Peeperkorn & Verouden (2014), p. 10.

⁴⁰ Peeperkorn & Verouden (2014), p. 13; Whish & Bailey (2012), p. 5.

⁴¹ Companies produce more products as long as it is still profitable for them. As the supply of products increases their price will decrease until it equals marginal cost. Geradin et al. (2014), however note that companies never actually calculate their marginal cost, p. 97.

⁴² Peeperkorn & Verouden (2014), p. 10, 14.

⁴³ Ibid. p. 57.

⁴⁴ Whish & Bailey (2012), p. 1–2; Geradin et al. (2012), p. 79–80.

problematic from the point of view of competition law only when a company possess a significant degree of it and exercises it abusively by bringing anti-competitive effects on the market and harm to consumer welfare.⁴⁵ As mentioned in the introduction, merger control acts as a type of *ex ante* control to avoid this abuse. In merger control the key concern is the degree of market power a company will acquire through a merger.⁴⁶

2.1.2. *Perfect Competition as an Ideal Market Structure*

The study of neoclassical economic theory often begins with the concept of *perfect competition*, which describes an ideal market structure in terms of competitiveness of the market. In order for a market structure to resemble perfect competition, specific conditions must exist. Perhaps the most relevant factor is the number of suppliers and buyers operating in the market. When a sufficient number of actors operate the market, none of them is able to lift or reduce the market price on their own. When there are enough suppliers from whom the consumer can choose products from, each supplier's output is so small, when compared to the total output on the market, that their decisions regarding the level of production cannot affect the market price. This, however, would not be the case without the other conditions of perfect competition in place. These conditions include the nonexistence of entry barriers (anyone can become a supplier, i.e. substantial resources are not needed), the homogeneity of products (the characteristics of the product do not vary between different suppliers), and full transparency (the consumers have the same knowledge about the market as the producers do).⁴⁷ Understandably, these are demanding conditions for a market to contain and perfect competition does not actually exist on any market.

According to neoclassical economic theory, perfect competition benefits consumers who are offered a wider selection of better products with lower prices and greater efficiency. Perfect competition is perceived to maximize consumer welfare and *social welfare* – which in neoclassical terms is understood as productive and allocative efficiency.⁴⁸

Productive efficiency refers to the costs of producing goods and services, which are the lowest possible under perfect competition. This benefits the whole society as its wealth is

⁴⁵ E.g. Article 102 of the TFEU lists unfair pricing practices, limitation of production or technical development as forms of this abuse.

⁴⁶ Peeperkorn & Verouden (2014), p. 56; Geradin et al. (2012), p. 78–79.

⁴⁷ Peeperkorn & Verouden (2014), p. 20.

⁴⁸ Whish & Bailey (2012), p. 4.

expended the minimum amount in the production process.⁴⁹ Productive efficiency contains a Darwinian view of the market as survival of the fittest: if a firm is less efficient it will exit the market and an efficient entrant will take its place.⁵⁰ Companies compete to become more efficient than their competitors in order to reduce prices and get more customers. Equilibrium will form where price and marginal cost of production intersect.⁵¹ In terms of merger control a merger will generate productive efficiencies if the newly formed entity is able to lower its production costs more than the companies can do separately.⁵²

Allocative efficiency refers to an ideal provision of economic resources directed at the market. Under perfect competition the allocation cannot be changed to make anyone better off without making someone else worse off. Resources are allocated perfectly as consumers are able to obtain the goods and services they wish at the price they are willing to pay. If the aggregate output would be smaller, not all of those who are willing could buy the product. On the other hand, if production rises, the price received from the product would be lower than the cost of its production.⁵³ In this case the producers would be spending more resources in this market than is efficient, while these resources could be used to satisfy consumer needs on other markets. The right output in the market leads to market price equalling marginal cost. Allocative efficiency is achieved because rational producers will expand production until it is no longer profitable, that is until the production of an extra unit will not earn them more than its production costs. In economic terms, the production will not be increased to a point in which the marginal cost would exceed marginal revenue.⁵⁴

In addition to productive and allocative efficiency, perfect competition is claimed to have a dynamic effect on innovation as well as technological research and development as companies strive to come up with better products than their competitors. This effect is called *dynamic efficiency*, which is not, however, as clearly captured by neoclassical economic model of perfect competition.⁵⁵ Although, in general, it is believed that innovation should be taken into consideration while assessing mergers – as increases in

⁴⁹ Whish & Bailey (2012), p. 5.

⁵⁰ Peeperkorn & Verouden (2014), p. 21.

⁵¹ Whish & Bailey (2012), p. 5.

⁵² Ma (2014), p. 123.

⁵³ See supra note 41.

⁵⁴ See e.g. Whish & Bailey (2012), p. 4–6; Peeperkorn & Verouden (2014), p. 21.

⁵⁵ Whish & Bailey (2012), p. 4; Peeperkorn & Verouden (2014), p. 5–7; Ma (2014), p. 123..

economic welfare often result from innovations – it is unclear how competition law should be enforced in order to promote dynamic efficiencies.⁵⁶

The different types of efficiencies are not always consistent with one another. For example mergers can produce productive efficiencies by lowering production costs at the expense of allocative efficiency if deadweight loss occurs through a more monopolistic market structure.⁵⁷ And, although allocative efficiency should produce optimal prices for consumers, it might stall innovation, i.e. dynamic efficiency, thus making the consumers worse off in the long run.⁵⁸

As already discussed, perfect competition does not occur in reality, and the critics of neoclassical economics believe that it would be more fruitful for economic theory to focus on market structures that actually exist. Additionally, the theory is said to neglect, among other things, consumer loyalty (a price increase will not be automatically followed by a loss of customers, who do not have information about cheaper substitutes) and the fact that not all producers are rationally maximising their profits.⁵⁹

2.1.3. *Monopoly, Oligopoly and Limited Competition*

Another model used in neoclassical economic theory to describe the effects of market structure on competition is *monopoly*. In a monopoly only one producer is operating on the market. Hence it can reduce its output and increase prices and maximise its profits without the fear of losing customers to competitors. If the producer is rational, as neoclassical theory expects it to be, this is exactly what happens when a monopolistic market structure exists.⁶⁰

Although a monopolistic market structure increases the welfare of the producer, the welfare of consumers and the society as a whole decreases. Not all consumers are able to obtain the products they need and would get under perfect competition, as the market price is well above marginal cost. This leads to allocative inefficiency called the *deadweight loss*. Wealth is transferred from consumers to the producer, and the economy is performing under its full potential.⁶¹ In addition, in a monopolistic market structure the producer's

⁵⁶ Ma (2014), p. 124–127; Peeperkorn & Verouden (2014), p. 37. See also infra note 62 on the debate on which type of market structure benefits dynamic efficiency the most.

⁵⁷ For “deadweight loss”, see section 2.1.3.

⁵⁸ Ma (2014), p. 123, 128–129.

⁵⁹ Peeperkorn & Verouden (2014), 8–9.

⁶⁰ Whish & Bailey (2012), p. 6; Peeperkorn & Verouden (2014), p. 22–23.

⁶¹ Geradin et al. (2012), p. 9; Whish & Bailey (2012), p. 6; Peeperkorn & Verouden (2014), p. 22–23.

production costs may increase, as it has no incentive to control its costs in order to be more efficient than its competitors which leads to productive inefficiency. There are differing views concerning monopolies and dynamic efficiency.⁶²

Since a monopoly has negative impacts on society's economic performance, it is not a desired outcome in competition policy. Additionally, consumer welfare is often a key goal in competition policy. Therefore, when evaluating whether a merger should be approved an outcome that would lead to a loss of consumer welfare is usually out of the question.⁶³

However, the creation of monopolistic market structures is not a common dilemma and merger control is more focused on companies acquiring or strengthening their market power.⁶⁴ A more central market structure in terms of this is *oligopoly*, which describes a market that is operated only by few suppliers. None of the producers are in a position of a monopolist that could individually decide the level of output on the market and set the market price to a level that benefits it the most. But the market is not operating under the conditions of perfect competition either, where suppliers would not have any influence on the level of output or the market price.

It is difficult to analyse this influence, but competition policy should pay attention to this, since anti-competitive outcomes often arise from oligopolies. In the case of mergers, these issues are likely to arise in the form of *coordinated effects* discussed in detail later on.⁶⁵ The European Commission has been cautious and challenged mergers if there is a likelihood of coordinated effects in a market that contains only two or three large companies.⁶⁶ Oligopolies are particularly relevant in terms of this research, as failing firm arguments are typically presented in relation to mergers, which take place in markets that have a limited number of competitors.

2.2.Modern Schools of Competition Law

Even though neoclassical economic theory has proven useful in illustrating the effects that different market structures have on competition, it has not been developed from the

⁶² Some have argued that a monopoly may improve innovation as the company does not have to worry about competition and it can focus on research and development. This would mean that competition policy might be harming innovation if it aims to preserve price competition in the markets. Others have heavily criticised this view stating that a monopoly does not actually have any reason to innovate, unlike companies facing fierce competition, as it continues to receive profits with its current product. Empirical studies tend to agree with the latter view. See e.g. Peeperkorn & Verouden (2014), p. 37–39; Ma (2014), p. 123.

⁶³ E.g. Whish & Bailey (2012), p. 1; Peeperkorn & Verouden (2014), p. 9, 23.

⁶⁴ Whish & Bailey (2012), p. 8.

⁶⁵ See section 2.2.5.

⁶⁶ Peeperkorn & Verouden (2014), p. 25, 35.

perspective of competition law. As perfect competition or monopolies do not occur in reality the application of these models is challenging in competition law enforcement. The following sections introduce schools of thought that have developed mostly during the latter part of the 20th century in order to correct this shortcoming. The analysis of competition law cases today is largely affected by the thinking developed in these schools.⁶⁷ It is of particular interest in this research to find out which schools of thought have had an influence on the European Commission's interpretation of the failing firm defence and merger control in general.

2.2.1. Harvard School and Market Concentration

The first wave of modern theory concentrating purely on competition policy was originated by a few scholars from Harvard University during the 1940's and 1950's.⁶⁸ *Harvard School* is the term used when their thinking and contribution to competition law is being referred to.

The main contribution of Harvard School is known as *Structure-Conduct-Performance* (S-C-P) paradigm. According to this paradigm, the market performance of companies is determined by their market behaviour which in turn is determined by the market structure – that is, the number of suppliers and buyers operating on the market.⁶⁹ Harvard School stressed especially the significance of market structure in determining the final outcome in the markets.⁷⁰

The data gathered by Harvard School scholars suggested that concentrated markets – i.e. markets operated only by few major companies – that had entry barriers, showed above average profitability. The policy recommendation of Harvard School for competition authorities was to concentrate on the market structure, in order to avoid large companies from profiting at the expense of consumers.⁷¹ Mergers affecting the market structure should be monitored and transactions leading to overly concentrated markets or the formation of entry barriers should be prohibited.⁷² These recommendations had

⁶⁷ Geradin et al. (2012), p. 76.

⁶⁸ The scholars included economists such as John Clark, Edward Mason and Joe Bain.

⁶⁹ According to Geradin et al. (2012) market performance can be defined as contribution to welfare which includes both economic efficiency and social progress in terms of distribution of revenue, growth and employment, p. 71.

⁷⁰ Peepkorn & Verouden (2014), p. 5–6.

⁷¹ Ibid.

⁷² Geradin et al. (2012), p. 71–72; Whish & Bailey (2012), p. 15–16.

considerable influence in US merger control.⁷³ However, Harvard School was even more interested in controlling companies already operating on concentrated markets.⁷⁴

Another way of understanding Harvard School thinking is to interpret that the protection of competitors, instead of the competition process, should be the focus of antitrust enforcement. Even nowadays, it is not uncommon to hear opinions calling for stronger protection of small companies against the actions of their larger competitors.⁷⁵ The idea is that competition law should level the playing field so that everyone would have equal opportunities to compete.⁷⁶ It has been argued, that competitors rather than competition has been protected by the European Commission in some of its decisions.⁷⁷

Although the S-C-P paradigm is not used anymore as an explanatory model, its influence is still visible. Market structure continues to be the starting point in the analysis of competition law cases. In merger cases market concentration can be used to estimate how likely anti-competitive behaviour would be after the merger.⁷⁸ However, today deducing competition concerns solely on the basis of market structure is not considered to be sufficient. The actual behaviour of companies in this market must also be anti-competitive. Additionally, the relationship of structure, conduct and performance is believed to be more interactive: it is recognized that market conduct and performance also affect the market structure.⁷⁹

2.2.2. *Chicago School and Economic Efficiencies*

The source of Harvard School criticism, which eventually led to the loss of its influence, can be located to another American university. During the 1960's and the 1970's scholars from the University of Chicago presented their views on competition law according to

⁷³ Peeperkorn & Verouden (2014), p. 5–6; Ma (2014), p. 119–120.

⁷⁴ Harvard School's recommendations included measures aimed at diluting existing markets as merger control was assessed to be unable to correct market concentration emerged without mergers. These ideas were influential in the United States during the 1960's and early 1970's. However, contemporary approaches to competition law believe *ex post* market control to be complex and time-consuming and therefore not likely to be as effective as merger control. In addition competition authorities are rarely in a position to assess precisely the 'correct' price level of the market, and therefore their actions might distort the competition process even further. *Ex ante* control is also considered to be more effective and more reasonable in terms of legal certainty. See e.g. Whish & Bailey (2012), p. 20–21, 817; Bengtsson et al. (2014), p. 544; Geradin et al. (2012), p. 71–72.

⁷⁵ Whish & Bailey (2012), p. 21–22; Ma (2014), p. 99.

⁷⁶ Geradin et al. (2012), p. 20.

⁷⁷ According to Geradin et al. (2012), the Commission has for example ordered dominant firms to raise their prices in order to enable the entry of new competitors whose costs are larger at the initial phase of starting operations on the market, p.20. See also Ma (2014), p. 99.

⁷⁸ E.g. Horizontal Merger Guidelines state that anti-competitive concerns are highly unlikely under certain market concentration levels, para 19.

⁷⁹ Peeperkorn & Verouden (2014), p. 7–8.

which there was no need to concentrate on markets that were becoming concentrated.⁸⁰ Their focus was on *economic efficiency*, which they believed should be promoted, when evaluating mergers and conducting competition policy in general.⁸¹

Chicago School saw efficiency as a key factor in the promotion of social welfare and argued that it should be placed above considerations over distribution of wealth between producers and consumers.⁸² On the other hand, protection of competitors as proposed by Harvard School was interpreted to harm consumers and social welfare: markets should be let take care of themselves through the logic of survival of the fittest, so that the most efficient firms would prevail while the weakest companies would exit the market.⁸³ Chicago School associates this logic with allocative efficiency: resources and products are allocated to those who value them the most even if this leads to market structures where firms have significant market power.⁸⁴ Higher concentration levels on the markets are not problematic and no public intervention is needed as long as they result in higher numbers of efficient firms.⁸⁵ If this thinking is taken to the extreme and other aims of competition policy – such as consumer welfare – are disregarded, even mergers creating monopolies could be accepted, if the price increases following the reduction of output of the merged entity are lower than the cost savings and other efficiencies that follow from the merger.⁸⁶

Chicago School believed that Harvard school had condemned market concentration without establishing that it would always lead to anti-competitive behaviour. By doing so Harvard School had also overlooked the efficiencies that result from mergers that lead to more concentrated markets.⁸⁷ According to Chicago School, larger companies tend to be more efficient and therefore able to sell better products to consumers at cheaper prices while making more profit than smaller firms. To Chicago School this was not an indication

⁸⁰ These scholars included economists such as George Stigler, Robert Bork and Richard Posner.

⁸¹ Economic efficiency can, according to Chicago School, be defined as the ratio between total wealth created and total wealth used. Although Chicago School favoured allocative efficiency, productive efficiencies are tend to be seen as the yardstick against which the efficiency gains of mergers are usually measured. These can be calculated by using reductions in price and increases in the level of output among other things. Ma (2014), p. 129; Geradin et al. (2012), p. 72–73; Peeperkorn & Verouden (2014), p. 6–7.

⁸² Geradin et al. (2012), p. 21.

⁸³ Whish & Bailey (2012), p. 21–22.

⁸⁴ Ma (2014), p. 123.

⁸⁵ Peeperkorn & Verouden (2014), p. 6–7.

⁸⁶ Geradin et al. (2012), p. 21.

⁸⁷ Such efficiencies include economies of scale and scope, cost reduction and product enhancement. *Economies of scale* follow from increasing production capacity which reduces production costs. The increased amount of output makes the production process more efficient. *Economies of scope* refer to lower production costs of two separate products. The production costs reduce as production of a larger range of products is transferred under single ownership. I.e. the common costs of production can be shared after a merger. Whish & Bailey (2012), p. 10; Peeperkorn & Verouden (2014), p. 16–17.

of unreasonable market power but of greater efficiency. Even if the firms would be able to make larger profits while growing, monopoly profits should not occur or at least they would not be durable since entry barriers are usually low.⁸⁸

Chicago School argued that efficiencies should not merely be taken into account in merger control, but rather they should be a central goal of it.⁸⁹ On the other hand, competition authorities should not concern themselves with market structures. Public intervention should be limited to cases of collusive behaviour which cannot be justified on the basis of efficiencies. The need to intervene should not arise outside concentrated, or *oligopolistic*, markets. However, unlike Harvard School suggested market structure alone cannot be the basis for intervention since efficiencies benefitting the whole society can occur also in oligopolistic markets if entry and exit barriers are low.⁹⁰

In addition, competition authorities should not intervene on the basis of the size of the firm.⁹¹ According to the minimalist competition policy of Chicago School intervention should only take place if anti-competitive behaviour on concentrated markets occurs. US competition law enforcement adopted this approach during the 1970's and especially during the 1980's.⁹² Efficiencies did not, however, become truly influential even in US merger control until the 1980's when the *efficiency defence* was established as a formal doctrine and the emphasis of the analysis was shifted away from market concentration.⁹³

2.2.3. Contestable Markets and Exit from the Market

The theory of contestable markets was developed during the 1980's and was clearly influenced by the prevailing Chicago School thinking.⁹⁴ According to this theory, optimal allocation of resources takes place if it is possible for firms to enter markets without

⁸⁸ Geradin et al. (2012), p. 73; Peepkorn & Verouden (2014), p. 6–7.

⁸⁹ However, a case-by-case analysis of efficiencies was considered to be problematic in terms of legal certainty: firms might find it difficult to assess whether the efficiencies following from their merger would be enough to compensate for the possible anti-competitive consequences. This is why Chicago School scholars argued that the thresholds, under which mergers could be challenged by the competition authorities, should be increased. Ma (2014), p. 120–121.

⁹⁰ Geradin et al. (2012), p. 74; Peepkorn & Verouden (2014), p. 6–7.

⁹¹ Whish & Bailey (2012), p. 21–22.

⁹² Geradin et al. (2012), p. 74; Whish & Bailey (2012), p. 21–22.

⁹³ Before this efficiencies were taken into account only in exceptional circumstances while the structural approach was continued to be applied. Ma (2014), p. 120–121. For 'efficiency defence' in EU merger control see section 3.4.3.

⁹⁴ The theory of contestable markets is not considered to be a major school of thought in terms of competition law development but it is included here since it seems to describe problems related to the application of the failing firm defence.

suffering costs that they cannot get back and exit the market without suffering losses. In other words, entry and exit from the market should be costless.⁹⁵

This is taking the idea of low entry barriers a step further while considering also exit barriers, which is important while discussing the failing firm defence. Free market economies need entrepreneurs to invest assets in new businesses and to enter new markets. Competition authorities are quick to judge barriers on entry and expansion, but according to economists it should be just as important to keep watch for exit barriers if the investment proves to be unprofitable. If exiting the market is not easy, it is likely that there is less enthusiasm towards entering risky markets.⁹⁶

Similarly to Chicago School's theories concerning efficient oligopolistic markets, contestable markets could be economically efficient with only a few or even a single producer. Competition authorities and consumers do not have to worry about anti-competitive behaviour in such markets, as new entrants can emerge if the producers increase prices and start receiving monopoly profits. The absence of entry may be regarded as a sign of a modest profit margin. In fact, in perfectly contestable markets the market price would actually equal marginal cost similarly as in the case of perfect competition.⁹⁷

The term *minimum efficient scale* is related to this. In some markets the market share of any company has to be very sizeable in order for the firm to be profitable, i.e. the minimum efficient scale is very large in relation to aggregate output. Some markets might even require that the production is in the hands of a single producer, i.e. a monopolist. While the theory of contestable markets suggests that this would not cause problems as new entrants can emerge, *Whish* and *Bailey* are more cautious: when monopoly is the natural market condition, public ownership or additional regulation should be considered.⁹⁸

2.2.4. Freiburg School and Ordoliberalism

Neoclassical economic theory, Harvard School and Chicago School are commonly credited as the leading schools of thought that have influenced competition law and merger control in the Western hemisphere. But when dealing with EU competition law, the intellectual

⁹⁵ Baumol (1982), p. 3–4, 14; Whish & Bailey (2012), p. 17.

⁹⁶ Baumol (1982), p. 4; Whish & Bailey (2012), p. 815.

⁹⁷ Companies operating on contestable markets must also be *efficient* as inefficiency is a similar “invitation” to entry as abnormal profits. Also similarly to perfect competition perfectly ‘contestable markets’ do not occur in reality. Baumol (1982), p. 2–5, 14.

⁹⁸ Whish & Bailey (2012), p. 10.

tradition developed in the University of Freiburg during the 1930's, known as *ordoliberalism*, should also be taken into account.

Ordoliberalism originated to counter ultraliberalism that was the prevailing dogma in early 20th century Germany. According to ultraliberalism, the state should not intervene to the relationships of economic agents under any circumstances. This policy led to a situation where in 1933, at the end of the Weimar Republic, some 4000 cartels were active in Germany. As the social and economic crisis developed in Germany in the beginning of the 1930's, a group of scholars from the University of Freiburg believed that it resulted from the abuse of private economic power, and that this power should be contained by a well-functioning legal system. They deduced that competition does not always occur spontaneously, and that government intervention is needed to establish and to promote it. Competition legislation was needed to stop companies from colluding with each other and eliminating competition by acquiring dominant positions in the markets.⁹⁹

At the same time Freiburg School scholars believed that economic freedom was needed to secure political freedom. Economic freedom was threatened both by political and economic power as neither the government nor the market could be fully relied upon. Ordoliberalism wished to establish a middle way between liberal free-market economy and central planning, which would include state intervention but contain its abuse with the help of detailed regulation.¹⁰⁰

After World War II ordoliberalism was adopted in West Germany where it started to influence the relationship between the state and the economy, including national competition policy which became imbedded with social goals. As Germany had the longest tradition of practicing competition law these ideas became dominant when competition law was started to be drafted and enforced in the European Community. Liberalism and the idea of unrestricted competition have been relatively weak in Germany which might partly explain the differences between EU and US competition policies.¹⁰¹

The goals of ordoliberal competition policy include both an economic and a political perspective. The main goal is perceived to be the freedom to compete. The economic perspective holds competition necessary for an efficient allocation of resources, whereas the political viewpoint favours increased private decision-making as a way to

⁹⁹ Geradin et al. (2012), p. 15–16; Ma (2014), p. 102–105.

¹⁰⁰ Ibid.

¹⁰¹ Ibid.

counterbalance state power. These viewpoints are not seen to be contradicting with one another as they ultimately lead to a similar outcome where the economy is working well because of political goals. However, economic success is not equated with constant growth but instead with economic performance, which is dependent on such factors as equal opportunity for all and a fair distribution of wealth.¹⁰²

Another goal is *complete competition* where no firm is in a position from which it could pressure other companies or set prices on its own. Instead the price should be determined in the market much like in the model of perfect competition. But unlike perfect competition, complete competition is based on a political concern that deals with the distribution of power. These ideas are represented in EU competition law which focuses on the structure of the market and the degree of dominance held by companies.¹⁰³ Protection of competitors has been noticeable especially in decisions adopted under Article 102 of the TFEU.¹⁰⁴

2.2.5. *Theories of Competitive Harm and Competitive Constraints*

Merger control deals with the prediction of future events as it assesses the likely effects mergers will have on competition. According to modern understanding of competition law the decision to prohibit a merger must be based on a *theory of competitive harm* that explains why competition would be harmed if the transaction took place. In addition the authority must show how the competitive structure will be better without the merger.¹⁰⁵

Two theories of competitive harm are relevant from the point of view of horizontal mergers. First of all, competition can be harmed if the competitive constraints, which the merging firms have imposed upon each other, will disappear following the merger and the new entity is able to raise prices regardless of the behaviour of other firms in the market.¹⁰⁶ In the most simplistic form this would happen if a market is consisting of two companies fiercely competing with each other that are planning to merge. Without the merger, the two companies could not raise prices above the competitive level because of the competition they face from each other. But after the merger, the new entity would face no competition and could lift prices without any fear of losing its customers to competitors. This is known

¹⁰² Ma (2014), p. 103.

¹⁰³ Ibid. p. 104–105.

¹⁰⁴ However, the role of ordoliberalism should not be exaggerated since a variety of factors have contributed to the development of EU competition law. Whish & Bailey (2012), p. 22.

¹⁰⁵ Ibid. p. 818.

¹⁰⁶ Cook & Kerse (2009), p. 203–204; Ma (2014), p. 175.

as *unilateral or non-coordinated effects*. Non-coordinated effects can take place even if the newly merged entity is facing competition on the market as the competitors might find it beneficial to follow the decision to raise prices.

According to another scenario, the market is operated by several producers, and the newly merged entity is able to coordinate its behaviour with them. This collective exercise of market power is known as *coordinated effects*.¹⁰⁷ Coordinated effects can appear in oligopolistic markets where each operator independently recognises the benefits following from uncompetitive behaviour.¹⁰⁸

In both of the scenarios described above, the key concern is the ability to exercise market power following the disappearance of *competitive constraints*.¹⁰⁹ Competitive constraints imposed by the competitors on each other guarantee that they cannot lift prices without losing customers. When these constraints are lost following a merger, price increases become profitable. Horizontal mergers are not nowadays prohibited because of the size of the companies involved. Instead prohibition follows if significant competitive constraints disappear, and the remaining competitors in the market are not able to exert strong enough competitive constraints on the merging party.¹¹⁰

Each of the theories presented in this Chapter attempt to explain how competition law and merger control should be enforced. Their recommendations have been influenced by the political ideologies and economic environments that were in place during the development of these theories. However, none of the theories encourage competition authorities to change their application of merger control rules during an economic crisis. As we move on to look at the merger control practice of the EU it will be interesting to see how these theories have affected it during different times of its development. In the final Chapters of this research the influence of these theories on the failing firm doctrine of the European Commission – including its development during the recent economic crisis – shall be assessed.

¹⁰⁷ E.g. Peepkorn & Verouden (2014), p. 66–67; Whish & Bailey (2012), p. 819.

¹⁰⁸ Cook & Kerse (2009), p. 204–207.

¹⁰⁹ Ma (2014), p. 175. However, in the case of coordinated effects

¹¹⁰ Peepkorn & Verouden (2014), p. 65–67.

3. Merger Control practice of the European Commission

This Chapter concentrates on how the theories discussed above have affected EU merger control by looking into the main features of the European Commission's merger control practice. This will include a look into the historical development of the merger control regime, a general outline of the goals intended to achieve by the screening of mergers, as well as an overview of the assessment procedure. The main emphasis, however, will be on the substantive assessment of mergers in order to clarify the factors that are assessed by the Commission when it decides whether or not a transaction can be approved. This will be highly relevant when discussing the appraisal of cases in which the failing firm defence has been invoked later on.

3.1. Development of EU Merger Control

We shall first turn to the historical development of merger control in the European Union. While discussing the events that have shaped the merger control regime the idea is also to introduce some key features of EU merger control that are still in place today.

Modern competition law was originated in the United States when Sherman Act prohibiting cartels and monopolisation of markets was passed in 1890.¹¹¹ Cartels and monopolies were a common phenomenon also in Europe already during the early 1900's.¹¹² However, economic liberalism was so influential that it was commonly believed that the freedom of contract also justified contracts that restricted competition. Although the negative impacts following from this were identified, competition law was not effectively enforced in Europe during the first half of the 20th century. The Great Depression and World War II also delayed the development of European competition law systems. It was only after the war when effective legislation banning cartels and the abuse of market power was enforced in Europe.¹¹³ The European Community had a major impact on this development.

¹¹¹ The development of mass production and railroads led to the creation of geographically wider markets in America. Larger corporations, known as "trusts", were able to benefit from this development by becoming the sole operators in some industries. During the late 19th century economic power was beginning to concentrate to the hands of these trusts. In order to guarantee functioning competition and to prohibit the abuse of market power exercised by the trusts, antitrust law was drafted. Ojala (2012), p. 47–48.

¹¹² For example Austria had passed legislation to ban cartels already before the Sherman Act was enacted.

¹¹³ Ojala (2012), p. 49–52.

3.1.1. Rome Treaty and Legal Basis for Merger Control

The 1951 Treaty of Paris already included competition law provisions prohibiting cartels and the abuse of economic power in steel and coal sectors.¹¹⁴ The creation of the European Community through the Treaty of Rome in 1957 expanded the competition provisions to cover all sectors of economy.¹¹⁵ These provisions were designed to complement other Treaty provisions which aimed to eradicate barriers of trade between Member States.¹¹⁶

An instrument designed specifically for the enforcement of these provisions was not adopted until Regulation 17/62.¹¹⁷ However, neither the Treaties nor Regulation 17/62 did include provisions on merger control. This followed at least partly from the objection of European companies who claimed that controlling their growth would harm their opportunities to compete with companies from the United States.¹¹⁸

Nonetheless, the European Commission interpreted that Article 86 of the Rome Treaty (now Article 102 of the TFEU), concerning the abuse of dominant position, granted it a significant amount of control concerning acquisitions of companies in the internal market – although this control was often somewhat informal. In 1973 the ECJ confirmed in *Continental Can*¹¹⁹, that the Commission did have jurisdiction over acquisitions in the internal market on the basis of Article 86.¹²⁰ The ruling gave the Commission more confidence and it continued to use the Article increasingly as its legal basis in assessing mergers during 1980's.¹²¹

The need for controlling large market transactions was discovered in the European Community around the time Harvard School was influential and recommended that the

¹¹⁴ Articles 65 and 66 of the Treaty establishing the European Coal and Steel Community, Treaty of Paris, 18 April 1951.

¹¹⁵ Treaty Establishing the European Community (Consolidated Version), Rome Treaty, 25 March 1957.

¹¹⁶ Geradin et al. (2012), p. 16; Ma (2014), p. 109–110. See also section 3.2.2.

¹¹⁷ Council Regulation (EC) No 17/62 of 6 February 1962 implementing Articles 85 and 86 of the Treaty, Official Journal 013, 21.02.1962, p. 204–211. Regulation 17/62 turned out to be influential allowing a Community competition policy to develop as duly noted in Recital 1 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, Official Journal L 1, 4.1.2003, p. 1–25. However under Regulation 17/62 the Commission ended up spending resources screening agreements that did not pose real threat to competition while more serious breaches could not be investigated because of the lack of resources. Regulation 1/2003 created a more decentralized enforcement of the competition rules. Geradin et al. (2012), p. 17–18.

¹¹⁸ Ma (2014), p. 149.

¹¹⁹ Judgment of the ECJ in Case C-6/72, *Europemballage Corporation and Continental Can Company Inc. v Commission*. EU:C:1973:22.

¹²⁰ According to the Court an *ex ante* system to control market transactions would be less problematic as opposed to forcing a newly merged entity to dissolve which is partly why the Commission was enabled to review mergers. Geradin et al. (2012), p. 498.

¹²¹ Cook & Kerse (2009), p. 3–4.

authorities should pay attention to the structure of markets. This might have encouraged the Commission to interpret the Treaty provisions in a way that allowed it to do so.

Article 85 (now Article 101 of the TFEU), prohibiting cartels and other agreements disrupting competition in the internal market, was believed not to apply to mergers until the ECJ's ruling in *Philip Morris*.¹²² As a result, the Commission started using Article 85 as another basis of jurisdiction for merger control.¹²³ The uncertainties that followed from the *Philip Morris* judgment concerning the correct legal basis helped the Member States to become convinced of the need for a separate merger regulation.¹²⁴

This need was becoming increasingly evident during the 1980's also because the number of transnational mergers started to increase. The European markets had become more integrated, as the Member States had intended, and European companies had grown strong enough to face global competition. If the internal markets were to concentrate further without any control, anti-competitive effects could have followed.¹²⁵ Meanwhile some Member States were developing their own merger control systems, which – if left to the sole competence of the Member States – might have caused difficulties later on. All these developments paved the way for the Merger Regulation of 1989.¹²⁶

3.1.2. 1989 Merger Regulation and 'One-Stop-Shop'

The Merger Regulation of 1989 was the first legal instrument that undoubtedly gave the European Commission jurisdiction over *some* of the mergers taking place in the internal market. From early on there has existed a division of labour between the Commission and national competition authorities (NCAs). The 1989 Regulation included the concept of *one-stop-shop* which has been an essential part of the EU merger control regime ever since. The purpose of one-stop-shop is to give the Commission exclusive competence to oversee mergers that possess *a community dimension*.¹²⁷

¹²² Judgment of the ECJ in Case C-730/79, *Philip Morris Holland BV v Commission*, EU:C:1980:209. See also Cook & Kerse (2009), p. 3–4.

¹²³ However, the Treaty provisions were not designed to be used as the legal basis for merger control which was also evident from the fact that the Treaty only provided the means for *ex post* control. Ojala (2012), p. 60. For *ex ante* control see *supra* note 74.

¹²⁴ Cook & Kerse (2009), p. 3–4.

¹²⁵ Ojala (2012), p. 60.

¹²⁶ Council Regulation (EC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, Official Journal L 395, 30.12.1989, p. 1–12. See also Bengtsson et al. (2014), p. 540.

¹²⁷ According to Recital 8 of the (current) Merger Regulation “provisions to be adopted in this Regulation should apply to significant structural changes, the impact of which on the market goes beyond the national borders of any one Member State. Such concentrations should, as a general rule, be reviewed exclusively at Community level, in application of a “one-stop shop” system and in compliance with the principle of

The Commission has jurisdiction over a merger only if the concentration reaches one of the turnover thresholds defined in Article 1 of the current Merger Regulation. The purpose of these thresholds is to provide a simple and an effective method for determining the competent authority. If a NCA and the Commission should disagree whether a concentration has a community dimension, the Commission has exclusive competence to decide about the matter.¹²⁸ However, such disagreements do not often arise as Articles 1 and 5(4) are fairly unambiguous about the turnover thresholds and the way in which the turnovers are calculated.

The referral system between the NCAs and the Commission was further developed by the 2004 Merger Regulation which has brought more flexibility to the question of jurisdiction.¹²⁹ Both the Commission and a NCA can refer a concentration prior to its notification to each other under Articles 4(4) and 4(5) or after the notification has taken place under Articles 9 and 22.¹³⁰ Furthermore the Commission and NCAs cooperate by assisting each other during the investigation of concentrations as stipulated by Article 19 and Recital 40 of the Merger Regulation.

3.1.3. 2004 Merger Regulation and SIEC test

The 1989 Regulation was considered a success. It did, however, go through gradual amendments including the adaptation of the simplified procedure which allows a swift procedure in cases where concentrations are clearly not going to raise concerns.¹³¹

Under the 1989 Regulation, the compatibility of a concentration with the internal market was assessed through the *dominance test*. According to this test, incompatibility with the

subsidiarity. Concentrations not covered by this Regulation come, in principle, within the jurisdiction of the Member States". See also Cook & Kerse (2009), p. 4.

¹²⁸ Judgment of the Court of First Instance in Case T-417/05, *Endesa v Commission*, EU:T:2006:219, para. 99. The exclusive jurisdiction of the Commission in these cases is also confirmed by Article 21(3) of the Merger Regulation which states that "no Member State shall apply its national legislation on competition to any concentration that has a Community dimension".

¹²⁹ Bengtsson et al. (2014), p. 544, 578. The functioning of the referral system is further clarified in Commission Notice on Case Referral in respect of concentrations, Official Journal C 56, 5.3.2005, p. 2–23.

¹³⁰ The parties to a concentration are encouraged to discuss about the effects of their transaction with the competent competition authority before officially notifying the merger. This is also known as the pre-notification phase (see section 3.3.2). See e.g. Bengtsson et al. (2014), p. 590.

¹³¹ See Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004, Official Journal C 366, 14.12.2013, p. 5–9. See also Bengtsson et al. (2014), p. 540–541.

common market would follow if a concentration would “create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it”.¹³²

The problem with this test was its inability to deal with competitive harm that was not following from the creation or strengthening of a dominant position. As discussed above, competitive harm can follow from a merger either because of coordinated or non-coordinated effects. The dominance test of the 1989 Regulation did take both of these effects into account but the focus on the creation or strengthening of a dominant position left ‘a gap’ by excluding cases where non-coordinated effects would arise without the creation of a dominant position. This is particularly likely to happen in oligopolistic markets as in the case of *Airtours*.¹³³

As the Commission tried to deal with this matter under the 1989 Regulation, it decided to prohibit the takeover of First Choice by Airtours – which would have left only three competitors in the market – on the basis of a collective dominant position. According to the Commission, the firms would have been able to exercise market power without coordination.¹³⁴ However, the General Court denied this interpretation stating that collective dominance occurs only in the case of *coordinated effects*.¹³⁵ The problem was that the transaction was not causing coordinated but unilateral effects without the creation of a dominant position, which the dominance test was unable to cover.¹³⁶ This was one of the main contributors to the decision to pass a new merger regulation in 2004.¹³⁷ The major change brought by the current Merger Regulation was the introduction of the *SIEC test* that replaced the dominance test.¹³⁸ This change helped to fill ‘the gap’ that was in the Commission’s powers in terms of being able to react to unilateral effects.¹³⁹

The current Article 2(3) still refers to the dominance test by stipulating that impediment of competition may take place *in particular* through the creation or strengthening of a

¹³² Article 2(3) of the 1989 Merger Regulation.

¹³³ Judgment of the Court of First Instance of 6 June 2002. Case T-342/99, *Airtours v Commission*, EU:T:2002:146.

¹³⁴ Case No IV/M.1524 *Airtours/First Choice*, Commission Decision of 22 September 1999, para 54.

¹³⁵ Boyce and others (2008) claim that the dominance test should not be blamed for the failure to deal with the matter but instead the General Court’s strict interpretation of the test which was overly emphasising dominance, p. 747.

¹³⁶ Whish & Bailey (2012), p. 864–865.

¹³⁷ However, Cook & Kerse (2009), note that during the review of the 1989 Regulation that was initiated in 2001 a change in the substantive test seemed unlikely, p. 191.

¹³⁸ The name of the test comes from the wording of Article 2(3) where *significant impediment of effective competition* is the decisive factor in finding a concentration incompatible with the common market.

¹³⁹ Bengtsson et al. (2014), p. 542.

dominant position. This wording was chosen in order to preserve the decisional practice of the Commission and case law of Community Courts under the dominance test.¹⁴⁰ Indeed, earlier case law is used in the appraisal of concentrations under the SIEC test. However, this should not be done without proper consideration. Dominance is no longer a necessary condition for a concentration to be found incompatible with the internal market and the absence of dominance does not guarantee its compatibility. The idea behind the new wording was clearly to widen the test of incompatibility which is now solely a matter of whether the concentration will impede effective competition regardless of dominance.¹⁴¹ Compared to its earlier decisional practice the Commission has under the SIEC test been more focused on the loss of existing competition while the creation or strengthening of a dominant position has been emphasised less.¹⁴²

The benefits of the SIEC test also include the fact that it is much closer to the substantive test used in the merger control system of the United States. The substantive assessment under the current Merger Regulation is more flexible and the Commission's powers to intervene in merger cases have increased.¹⁴³ The Commission has also become more tolerant towards efficiency gains that mergers may create.¹⁴⁴ This is compatible with the effects-based approach whereas the practice under the dominance test represented a more formalistic approach.¹⁴⁵ This amendment has received praises as the Commission has been more willing to perform broader analyses of the market dynamics related to the notified concentrations as opposed to relying purely on the static competitive harm theories.¹⁴⁶ The downside is that the effects-based approach is also more complex and time-consuming as it requires substantial economic evidence.¹⁴⁷

The Commission has attempted to diminish uncertainties regarding its application of the Merger Regulation by offering various non-regulatory documents such as guidelines and notices.¹⁴⁸ In the field of horizontal mergers, the Commission shed more light into its appraisal process by publishing the Horizontal Merger Guidelines which codified previous

¹⁴⁰ Recitals 25 and 26 of the Merger Regulation; Horizontal Merger Guidelines, paras. 2, 4. See also Cook & Kerse (2009), p. 190.

¹⁴¹ Recital 25 of the Merger Regulation. See also e.g. Bengtsson et al. (2014), p. 673–674.

¹⁴² Cook & Kerse (2009) p. 190–191.

¹⁴³ Bengtsson (2014), p. 542.

¹⁴⁴ Cook & Kerse (2009), p. 190.

¹⁴⁵ Bengtsson et al. (2014) p. 692–693. See also Geradin et al. (2012), p. 19.

¹⁴⁶ Boyce et al. (2008), p. 748–749.

¹⁴⁷ Bengtsson et al. (2014), p. 694.

¹⁴⁸ Boyce et al. (2008), p. 750. See complete list on European Commission's website, *Mergers – Legislation* <http://ec.europa.eu/competition/mergers/legislation/legislation.html>.

decisional practice.¹⁴⁹ The effects-based approach is an inherent feature of these Guidelines.¹⁵⁰ Although the guidelines and notices are not legally binding instruments the parties to a concentration can rely upon them against the Commission itself.¹⁵¹

3.2. Goals of EU Merger Control

This section aims to present the goals that are intended to be achieved through EU merger control. The matter is by no means irrelevant. Companies, that are planning to merge, need to be aware of what the Commission is attempting to achieve in order to assess whether their merger will be cleared. Ambiguity regarding the goals of merger control will create uncertainty among European companies and stall their growth.¹⁵² In terms of this research, it is also necessary to understand the goals behind the merger control rules, as they are bound to affect the application of these rules – including the Commission’s approach to failing firm arguments. The goals of EU merger control also indicate which schools of thought introduced in Chapter 2 have had an impact on the Commission’s merger control practice.

3.2.1. *Preference of Consumer Welfare over Total Welfare*

In competition policy, *consumer welfare* refers to the level of benefits consumers extract from the competition process. The use of consumer welfare as a goal of competition policy has direct effects on merger control as concentrations that are harmful to consumers cannot be cleared even if this harm could be compensated by the benefits and efficiencies following from the transaction.¹⁵³ In other words, when a concentration would enable the merging parties to save costs in production – and enable them to direct assets to different markets – but could deprive consumers from “low prices, high quality products, a wide selection of goods and services, and innovation” it cannot be approved.¹⁵⁴

The emphasis of consumer welfare as a goal of merger control is opposed by those who consider that the assessment of mergers should focus on total welfare, as all the benefits that the transaction generates should be taken into account regardless of who is benefitting from them. Therefore Chicago School scholars oppose consumer welfare as a goal of

¹⁴⁹ See e.g. Kokkoris (2006), p. 495–496; Bengtsson et al. (2014), p. 542–543.

¹⁵⁰ Horizontal Merger Guidelines, para 13. See Bengtsson et al. (2014), who consider this to be a major amendment in the evolution of EU merger control, p. 542–543.

¹⁵¹ Judgment of the Court of First Instance in Case T-114/02, *BaByliss v Commission*. EU:T:2003:100.

¹⁵² Geradin et al. (2012), p. 23–24.

¹⁵³ Bengtsson et al. (2014), p. 669–670.

¹⁵⁴ Horizontal Merger Guidelines, para. 8.

merger control as it contradicts the objective of allocative efficiency.¹⁵⁵ However, Chicago School has been criticised for sidelining the fact that companies might exaggerate the efficiency gains their transaction produces in which case mergers might decrease consumer welfare while not benefitting the society as a whole.¹⁵⁶

Whereas, according to the total welfare approach wealth transfers from consumers to producers are regarded as neutral, they cannot be accepted by the consumer welfare model.¹⁵⁷ The choice between these two models has been clearly made in favour of consumer welfare in EU merger control. The importance of consumer welfare is expressed in Article 2(1)(b) of the Merger Regulation according to which the Commission, when assessing mergers shall take into account “the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition”. Possible efficiencies following from a merger must also benefit the consumers.¹⁵⁸ The Commission, however, does not consider efficiencies and consumer welfare as contradictory concepts as according to it, competition “encourages enterprise and efficiency, creates a wider choice for consumers and helps reduce prices and improve quality”.¹⁵⁹

According to many estimates, consumer welfare is emphasised by the Commission increasingly.¹⁶⁰ But others note that it has been central in EU competition law early on.¹⁶¹

3.2.2. *Tool for Market Integration?*

Market integration has been recognised as a goal of EU competition law ever since the ECJ's decision in *Continental Can* where the Court concluded that the creation of a dominant position “could jeopardize the proper functioning of the Common market”.¹⁶² The idea behind this goal is that the removal of trade barriers, which is achieved through

¹⁵⁵ Bengtsson et al. (2014), p. 669–670; Van den Bergh & Camesasca (2006), p. 37. See also Ma (2014), p. 96.

¹⁵⁶ Ma (2014), p. 134–135.

¹⁵⁷ Van den Bergh & Camesasca (2006), p. 37, 41–42. See also Ma (2014), p. 96.

¹⁵⁸ The importance of consumer welfare is also expressed in the competition law articles of the TFEU since e.g. the efficiency defence under Article 101(3) cannot be accepted without consumers benefiting from it.

¹⁵⁹ European Commission, “*Why is competition policy important for consumers?*”,

http://ec.europa.eu/competition/consumers/why_en.html.

¹⁶⁰ Geradin et al. (2012), p. 22; Bengtsson et al. (2014), p. 545. According to Van den Bergh & Camesasca (2006), consumer welfare has gained more ground from other goals such as market integration and individual economic freedom, p. 37–39.

¹⁶¹ See *Continental Can* (supra note 119), para 26; Bengtsson et al. (2014), p. 575.

¹⁶² See *Continental Can* (supra note 119), para. 25. See also judgment of the ECJ in Cases C-56/64 and C-58/64, *Consten and Grundig v Commission of the EEC*. EU:C:1966:41. Because of this Geradin et al. (2012) argue that market integration could in fact be the main goal of EU competition law. This is not considered to be ideal by everyone. According to Ma (2014) the competition law goal of economic efficiency has been sacrificed over further strengthening the internal market, p. 94–96.

the transnational legislation of the EU, would be in vain if companies were allowed to divide the European markets into separate domestic sections.¹⁶³ In order to prevent this from taking place, the merger control system should block measures that would isolate domestic markets from each other and clear cross-border transactions that generate more trade between the Member States.¹⁶⁴

Whereas consumer welfare is recognised as a legitimate goal of merger control in several competition law systems – including that of the United States – market integration is more of a unique feature of EU competition law. Some have estimated that market integration considerations have caused the Commission to prohibit behaviour that probably would have been accepted by other competition authorities assessing cases purely on economic grounds.¹⁶⁵ What makes this problematic is the fact that market integration is partly in conflict with other, more legitimate, competition law goals such as economic efficiency and consumer welfare which might suffer because of this.¹⁶⁶

3.2.3. *Ambiguous Role of Industrial Policy and Economic Efficiency*

When a merger decision has particular importance for a Member State – for instance when the creation of a national champion that is better equipped to compete in global markets is on the line – its government may try to persuade the Commission to take into account its national industry.¹⁶⁷ Similarly, when a national company is threatened to be taken over by a foreign competitor, a Member State might be worried not only because of the loss of competition but also because of the loss of tax revenue.¹⁶⁸

EU competition policy and the European Commission's decisions on mergers have at times been criticised for favouring European companies. The Commission's objectivity might become blurred and interpretation of the rules more lenient, when it is dealing with an important European firm whereas in the case of e.g. American companies there is no such incentive. *Industrial policy* is clearly on the agenda of the Commission.¹⁶⁹ But is it and should it be pursued through EU's competition policy as well?

¹⁶³ Van den Bergh & Camesasca (2006), p. 45.

¹⁶⁴ Whish & Bailey (2012), p. 23–24.

¹⁶⁵ Ibid.

¹⁶⁶ Ma (2014), suggests that the Commission should pursue market integration through other means and not entangle it with competition policy, p. 46–47.

¹⁶⁷ See e.g. Case No COMP/M.5830 *Olympic/Aegean Airlines*, Commission Decision of 26 January 2011.

¹⁶⁸ Whish & Bailey (2012), p. 814, 825.

¹⁶⁹ European Commission Website, *Industrial Policy*, http://ec.europa.eu/growth/industry/policy/index_en.htm.

Geradin and *Girgenson* note that “industrial policy has always been present in European merger control even though its influence has decreased considerably following the adoption of the Merger Regulation” of 1989.¹⁷⁰ For instance, in *Mannesmann/Vallourec/Ilva*¹⁷¹ the clearance of the concentration – which the Commission based on a somewhat questionable interpretation of the likelihood of entry on the market – was desirable from the point of view of industrial policy.¹⁷²

The European Commission, however, refuses to see competition and industrial policy contradictory to each other. Instead, the Commission believes that “competition within the EU helps make European companies stronger outside the EU too – and able to hold their own against global competitors”.¹⁷³ The Commission argues that these two policies share similar goals – such as promotion of innovation and economic growth – but it has not explained how clashes between the two potentially conflicting policies would be resolved.¹⁷⁴

Some EU law scholars are not as optimistic. *Van den Bergh* and *Camesasca* believe that industrial policy and competition policy perceive the functioning of markets differently. Competition policy is focused on the allocation of resources, whereas industrial policy has an inherent need to intervene on the market which is why the two policies are likely to run into conflict.¹⁷⁵ Others are not as worried as they note that there is little room for industrial policy considerations within the appraisal process of EU merger control. Moreover, the Commission does not possess powers to exempt concentrations that are incompatible with the internal market and its decisions are subject to judicial review.¹⁷⁶

However, in *Aerospatiale*¹⁷⁷ – the first case in which the failing firm defence was invoked in EU merger control – industrial policy considerations were disregarded although the college of Commissioners was not unanimous about this when it blocked the merger. Nevertheless, *Whish* and *Bailey* believe that the case set a precedent as the concentration’s

¹⁷⁰ Geradin & Girgenson (2012).

¹⁷¹ Case No IV/M.315 *Mannesmann/Vallourec/Ilva*, Commission Decision of 31 January 1994.

¹⁷² Cook & Kerse (2009), p. 266–267.

¹⁷³ European Commission website, *Why is competition policy important for consumers?*, http://ec.europa.eu/competition/consumers/why_en.html.

¹⁷⁴ Ma (2014), p. 100–101.

¹⁷⁵ Van den Bergh & Camesasca (2006), p. 50. See also Ma (2014), p. 100–101.

¹⁷⁶ Cook & Kerse (2009), p. 193. See also Boyce et al. (2008), who, however, note that merger decisions rarely end up being subject to judicial review, p. 749.

¹⁷⁷ Case No IV/M053 *Aerospatiale Alenia/de Havilland*, Commission Decision of 2 October 1991.

compatibility with the common market was evaluated purely on the basis of the effect which it would have on competition.¹⁷⁸

In addition to the abovementioned goals, the European Commission's merger control and its competition policy at large take into account other factors. Some believe that EU competition policy has in recent years witnessed an increase in its objectives, as a whole range of different *social, political, and environmental goals* have gained ground in EU law.¹⁷⁹ This is also noted in the Merger Regulation as Recital 23 states that the Commission "must place its appraisal within the general framework of the achievement of the fundamental objectives" of the European Union. The influence of these objectives on e.g. EU merger control has been criticised.¹⁸⁰ However, the effect of such fundamental objectives should not be exaggerated as they cannot be used to clear anti-competitive mergers and to circumvent Article 2(3) of the Merger Regulation.

Nonetheless, EU competition policy and merger control have several goals – not all of which are completely compatible with each another. The emphasis placed on each objective changes over time and is affected by issues such as economic development.¹⁸¹ Some have suggested that a hierarchy of goals could enhance legal certainty and consistency in the enforcement of these rules.¹⁸²

However, the goal, which is valued the most by the law and economics approach, seems to be less influential in EU merger control. The Commission has had a notoriously difficult relationship with the goal of *economic efficiency*. This is not to say that the Commission would disregard efficiency claims in its appraisal of concentrations.¹⁸³ But whereas US merger control is considered to have developed hand in hand with economic theories concerning competition, the European Commission has been less enthusiastic about adopting new ideas which has become apparent in its attitude towards efficiency claims.¹⁸⁴

¹⁷⁸ Whish & Bailey (2012), p. 902.

¹⁷⁹ Ma (2014), p. 94–95.

¹⁸⁰ Whish & Bailey (2012), p. 825.

¹⁸¹ Gerardin et al. (2012), p. 23

¹⁸² Ma (2014), p. 116.

¹⁸³ Recital 29 of the Merger Regulation states that "it is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration would not significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position".

¹⁸⁴ Still during the 1990's the Commission disregarded the use of efficiency claims. Ma (2014), p. 122; Van den Bergh & Camesasca (2006), p. 43–44.

Only after the current Merger Regulation came into force has the Commission's attitude gradually changed more in line with theories supporting efficiencies. Nevertheless, it can be interpreted that the influence of Chicago School has not been as influential in EU as in US antitrust enforcement and merger control.

3.3.Main features of the Procedure under the Merger Regulation

The purpose of the following section is to shed light on the procedure under both the Merger Regulation as well as the Implementing Regulation.¹⁸⁵ The objective is to illustrate how EU merger control works in practice. Understanding these procedural factors is also necessary when moving on to analyse the individual decisions of the European Commission concerning the failing firm defence.

3.3.1. Standstill Obligation during the Examination of the Notification

Merger control of the European Union is based on the premise that while in general corporate transactions have positive effects, they should be controlled in order to avoid permanent damage to competition in the internal market.¹⁸⁶ To ensure that concentrations that may significantly impede efficient competition do not take place, Article 4(1) of the Merger Regulation stipulates that transactions with a community dimension must be notified to the European Commission before their implementation. This is complemented by the *standstill obligation* defined in Article 7(1) according to which a “concentration with a Community dimension... shall not be implemented either before its notification or until it has been declared compatible with the common market”.¹⁸⁷ The Commission also possesses powers guaranteeing that these obligations are followed and that it receives the necessary information in order to assess the potential effects of the transaction.¹⁸⁸

However, in order to achieve the positive effects that market transactions produce – such as the improvement of economic efficiency, promotion of growth and enhancement of consumer welfare – merger control has to be proportionate in terms of its purpose.¹⁸⁹ The

¹⁸⁵ Council Regulation (EC) No 802/2004 of 21 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, Official Journal L 33, 30.4.2004, p. 1–39 (hereafter Implementing Regulation).

¹⁸⁶ Recitals 3–5 of the Merger Regulation.

¹⁸⁷ However, derogation from this obligation is accepted under Article 7(3) if the financial viability of the parties is at risk without the implementation of the transaction.

¹⁸⁸ Article 14 and 15 of the Merger Regulation define the fines and periodic penalty payments that the Commission can impose. Article 11 expresses how the Commission can request information from the undertakings while Articles 12 and 13 outline its powers to inspect the facilities of the undertakings.

¹⁸⁹ Recital 6 of the Merger Regulation; Bengtsson et al. (2014), p. 617.

Merger Regulation aims to assure this by demanding the Commission to carry out its assessment without unnecessary delays.¹⁹⁰

Before even notifying the concentration, the parties usually contact the Commission in order to hear its preliminary informal estimation of the transaction.¹⁹¹ This is known as the pre-notification phase, during which the parties are already informed of potential concerns that the Commission might have. Given the tight time frame following the notification of the concentration, the pre-notification phase is recognized as an important step in enabling the procedure to go smoothly.¹⁹²

The examination period following the notification of the concentration is known as *Phase I*, during which the European Commission investigates whether the merger raises serious doubts as to its compatibility with the internal market. The Commission is under the obligation to collect sufficient amount of data in order to determine whether the transaction will significantly impede competition. Within the Commission, the Directorate-General for Competition handles the investigation. The sources of information include market reports and studies, annual reports of the parties, contents of the notification, and comments from third parties among other documents.¹⁹³ The third parties include suppliers, competitors, and customers of the merging companies. Their opinions are compared to the arguments that the notifying parties have raised in their submissions or in the voluntary state of play meetings with the Commission.¹⁹⁴ The gathered information is used to outline the market structure and its conditions.¹⁹⁵

The evidence used varies case by case as it depends on the characteristics of the market that is being examined.¹⁹⁶ Because of the strict time limits of Phase I, in-depth econometric

¹⁹⁰ Article 10 of the Merger Regulation sets time limits to the assessment proceedings. If the Commission should fail to deliver its decision on time the concentration will be deemed compatible with the internal market.

¹⁹¹ Recital 11 of the Implementing Regulation.

¹⁹² In addition, during the pre-notification phase it may become apparent that the concentration does not raise any concerns and that the simplified procedure, which requires much less submissions of information, can be applied. Approximately 60 percent of all notifications fall under the simplified procedure which involves little or no substantive appraisal. Bengtsson et al. (2014), p. 625, 657; Cook & Kerse (2009), p. 211–212; Boyce et al. (2008), p. 694.

¹⁹³ Bengtsson et al. (2014), p. 622–623, 667; Cook & Kerse (2009), p. 195

¹⁹⁴ European Commission, *Best Practices on merger control proceedings*, <http://ec.europa.eu/competition/mergers/legislation/proceedings.pdf>. See also Bengtsson et al. (2014), p. 683–684; Boyce et al. (2008), p. 707.

¹⁹⁵ See Article 2(1) of the Merger Regulation which lists issues the Commission considers relevant in relation to the conditions in the markets affected by the merger.

¹⁹⁶ Commission Notice on the definition of relevant market for the purposes of Community competition law, Official Journal C 372, 9.12.1997, p. 5–13 (hereafter Market Definition Notice), para 25.

analysis can often only take place during Phase II investigations.¹⁹⁷ The need for sophisticated financial data is especially relevant when the Commission is faced with failing firm arguments, the appraisal of which always requires in-depth analysis.¹⁹⁸

3.3.2. *Decision Regarding the Compatibility of the Merger*

In the majority of cases the number of competitors in the relevant market and the sizes of their market shares is enough to conclude whether competition concerns will arise.¹⁹⁹ If the Commission comes to the conclusion that the concentration does not raise serious doubts it will be declared compatible with the common market.²⁰⁰ Even if competition concerns do arise the transaction can still often be cleared under Article 6(2) of the Merger Regulation as the parties offer sufficient remedies – modifications to the transaction guaranteeing “the continuation of competition on the market” – that dissolve such concerns.²⁰¹ Structural remedies, divestitures in particular, are preferred by the Commission because of their effectiveness and easy implementation. Commitments relating to the future behaviour of the merged entity are less easy to enforce.²⁰² Around 5 per cent of concentrations notified to the Commission require modifications and are approved under remedies.²⁰³

In a handful of cases competition concerns do arise and *Phase II* proceedings are initiated under Article 6(1)(c).²⁰⁴ A more in-depth investigation of the likely effects of the concentration will follow and it is concluded by a decision adopted by the College of Commissioners pursuant to Article 8 of the Merger Regulation. The purpose of this phase is to ensure a more thorough look at the concerns that arose during the Phase I investigation. The Commission is likely to acquire more extensive data and apply econometric techniques in its analysis.²⁰⁵ The parties may offer the Commission commitments at any point of the investigation in order to dissolve these concerns. If

¹⁹⁷ Bengtsson et al. (2014), p. 684

¹⁹⁸ See section 4.2.4. on the appraisal of the first failing firm criterion.

¹⁹⁹ Cook & Kerse (2009), p. 215.

²⁰⁰ Article 6(1)(b) of the Merger Regulation.

²⁰¹ European Commission, *Merger control procedures*.

http://ec.europa.eu/competition/mergers/procedures_en.html. It is essential that the initiative to use remedies comes from the parties, the Commission cannot impose them. Commission Notice on remedies acceptable under the Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 , Official Journal C 267, 22.10.2008, 1–27 (hereafter Remedies Notice), para. 85.

²⁰² Remedies Notice, para 17. See also Bengtsson et al. (2014), p. 754–755.

²⁰³ Whish & Bailey (2012), p. 884.

²⁰⁴ Whereas the Competition Commissioner is empowered to adopt Phase I clearances the decision to start Phase II proceedings requires the approval of the Legal Service and the President of the Commission. Finally decisions following Phase II investigations are adopted by the full College of Commissioners. See e.g. Boyce et al. (2008) p. 692.

²⁰⁵ Cook & Kerse (2009), p. 218.

competition concerns are assessed to be unlikely or if they are removed by the remedies offered by the parties, a clearance decision will follow.²⁰⁶

If the Commission is likely to conclude that the concentration is incompatible with the common market, before issuing its decision it will send a Statement of Objection (SO) to the notifying parties where the doubts concerning the compatibility of the transaction are discussed. After this the parties can still try to persuade the Commission as they have the right to respond to the SO in writing as well as ask an oral hearing to be held.²⁰⁷ If the Commission does not change its mind, a decision prohibiting the merger in accordance to Article 8(3) shall be issued. This takes place extremely rarely.

All decisions of the Commission are subject to judicial review exercised by the General Court – which acts as the court of first instance on competition matters – and ultimately by the Court of Justice if an appeal is made after the General Court’s judgment. The parties, as well as third parties who have an interest on the matter, have the right to appeal within two months of the decision.²⁰⁸

3.4.Substantive Appraisal of Mergers

In order for the European Commission to accept the failing firm arguments invoked by the merging parties and clear their transaction it must be compatible with Article 2(3) of the Merger Regulation. This is dependent on the Commission’s substantive appraisal of the merger. We shall now take a closer look at how the Commission assesses the harm a concentration might produce in the markets and subsequently decides whether the merger can be cleared. Understanding the logic of this appraisal process is crucial when discussing the Commission’s decisions relating to the failing firm defence.

Although the possible anti-competitive effects arising from mergers usually have to be analysed case-by-case, the way in which these effects are identified is rather standardised. The Commission wishes to define two factors: the relevant market that is affected by the concentration, and the effect which the merger will have on the market structure and competition on this market. In particular, the Commission is interested in finding out

²⁰⁶ Article 8(1) and (2) of the Merger Regulation. See also Bengtsson et al. (2014), p. 642.

²⁰⁷ See Articles 13(2) and (3) of the Implementing Regulation. See also European Commission, *Merger Control Procedures*, http://ec.europa.eu/competition/mergers/procedures_en.html.

²⁰⁸ Articles 256 and 263 of the TFEU. Article 263 requires that the matter is “of direct and individual concern” to the third party.

whether the concentration is able to increase prices in the relevant market independently or together with other firms.²⁰⁹

3.4.1. *Definition of the Relevant Market and Identification of Competitive Constraints*

The Commission's assessment of a merger, case begins with the definition of the relevant market which the ECJ has confirmed to be "a necessary precondition for any assessment of the effect of a concentration on competition".²¹⁰ This includes the definition of both the relevant *product market* as well as the relevant *geographical market*.²¹¹ The idea is to identify the choices and substitutes available for the customers within the area in which the parties to a concentration are competing.²¹²

When a horizontal merger takes place, competition is always lost to some extent. Whether the deterioration of competition is significant depends on the *competitive constraints* that the merging parties are facing from each other and other competitors in the market. Market definition is needed to identify these competitive constraints.²¹³ If the firms in question compete mainly against each other it is likely that the newly merged entity could lift its prices without the fear of losing customers (non-coordinated effects). Additionally, even if other competitors would remain on the market, they might find it profitable to coordinate their market behaviour with the newly merged entity (coordinated effects).²¹⁴

The most important single factor when defining the relevant markets is *demand-side substitutability*.²¹⁵ As stated in the Market Definition Notice, a firm cannot have a significant impact on the prevailing market prices, if its customers are in a position to switch easily to alternative products. Therefore, market definition is needed to identify the

²⁰⁹ Whish & Bailey (2012), p. 25–26; Bengtsson et al. (2014), p. 671, 675; Cook & Kerse (2009), p. 212.

²¹⁰ *France and others v Commission* (see supra note 11), para. 143. However, it should be noted that nowadays there exists a broad agreement among competition authorities that market definition is not always well-suited or obligatory in all merger cases as market share levels and market concentration might offer limited value in the analysis of certain types of markets. See OECD (2012), p. 11–12.

²¹¹ Horizontal Merger Guidelines, para. 10.

²¹² The relevant product market is comprised of all products and/or services which are interchangeable or substitutable, because of their characteristics, prices and intended use whereas the relevant geographic market consists of "the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different". Market Definition Notice, paras. 7–8. See also Cook & Kerse (2009), p. 215–216.

²¹³ Market Definition Notice, para. 2.

²¹⁴ Horizontal Merger Guidelines, para 22. See also Whish & Bailey (2012), p. 28. For coordinated and non-coordinated effects see section 2.2.5.

²¹⁵ Bengtsson et al. (2014), p. 674.

alternative sources of supply for the customers of the undertakings involved in the geographic area in which they operate.²¹⁶

Demand-side substitutability is tested in the EU – as well as in the US antitrust law – through the *SSNIP test* which estimates how customers would react to a hypothetical small but significant (5 to 10 per cent) non-transitory permanent increase in price.²¹⁷ If substitution is enough to make the price increase unprofitable because of the resulting loss in sales, additional substitutes and areas are included to the analysis. This is done until the set of products and geographical areas is such that small but permanent increases in relative prices would be profitable.²¹⁸ This is the market that the Commission shall assess.

3.4.2. *Market Power in the Relevant Market*

As important as market definition is, it is only the first step in merger analysis.²¹⁹ Market definition is not an end itself but instead it is used to identify whether the relevant undertakings possess *market power*.²²⁰

There exists no instrument that would clearly measure market power. Instead competition authorities and courts must rely on a variety of concepts, instruments, and criteria in order to deduce the degree of market power that exists or is likely to exist after the proposed transaction.²²¹ Whether the merger will lead to the creation of a harmful amount of market power, depends on how it will change the parties' abilities and incentives to impede competition, and whether third parties are able to limit the use of their market power. The first indicators that are used to estimate this are the market share figures of the companies and the level of market concentration in the market.²²²

First of all, market shares play a role in determining if a concentration is suitable for the simplified procedure.²²³ Similarly market shares exceeding 50 per cent can be regarded in

²¹⁶ Market Definition Notice, para. 13.

²¹⁷ SSNIP stands for small but significant and non-transitory increase in price. The SSNIP test was formally established in the Market Definition Notice although the Commission had applied it even before this. The test was introduced in US merger control already during the 1980's. See Bengtsson et al. (2014), p. 671, 679.

²¹⁸ Market Definition Notice, para. 17.

²¹⁹ Its results must also be critically assessed and weighed against other evidence. See Case No COMP/M.5658 *Unilever/Sara Lee Body Care*, Commission Decision of 11 November 2010, para. 187; Bengtsson (2014), p. 672.

²²⁰ Cook & Kerse (2009), p. 216. For market power see section 2.1.1.

²²¹ Geradin et al. (2012), p. 81.

²²² Horizontal Merger Guidelines, para. 14. See also Leivo et al. (2012), p. 1138, 1142–1143.

²²³ A concentration where “the market share of the undertakings concerned does not exceed 25 %” is “presumed to be compatible with the common market”. Recital 32 of the Merger Regulation; Horizontal Merger Guidelines, para. 18. This is known as the ‘*safe harbour*’.

themselves as “evidence of the existence of a dominant market position”.²²⁴ Additionally, other conclusions can be drawn from market share figures: if the merging entity should have a much larger market share than its biggest rival, the case is likely to be examined thoroughly. In the case of oligopolistic markets, the symmetry of market shares may raise doubts as a clearance decision could lead to collective dominance and coordinated effects.²²⁵

Another way to approach the subject of market power is to focus on the level of concentration by looking at the combined market share of the biggest firms on the market. For example, if a market has a dozen competitors but its four largest firms have a combined market share of over 75 percent, the existence of an oligopoly is very likely. A more sophisticated calculation of market concentration includes the use of concentration indices, such as the *Herfindahl–Hirschman Index (HHI)* used by many competition authorities including the European Commission. The HHI can be calculated in accordance to paragraph 16 of the Horizontal Merger Guidelines by “summing the squares of the individual market shares of all the firms in the market”. The larger the number, the more concentrated the market is (10,000 is a monopoly and 0 is perfect competition).²²⁶ The Commission is unlikely to identify horizontal competition concerns in a market with a post-merger HHI below 1000.²²⁷ However, the analysis should not be solely based on the HHI since it gives a static view of the market.²²⁸

3.4.3. *Countervailing Factors and Counterfactual Analysis*

Although offering a relevant starting point for the analysis, the importance of market share figures and market concentration is limited in the appraisal of the effects that the merger is likely to cause on competition.²²⁹ Other factors that should be taken into consideration include *buyer power* (i.e. “bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its size, its commercial significance to the seller, and its ability to switch to alternative suppliers”), and the likelihood of *entry* (“when entering a

²²⁴ Horizontal Merger Guidelines, para. 17.

²²⁵ Cook & Kerse (2009), p. 242.

²²⁶ Geradin et al. (2012), p. 88, 507.

²²⁷ Horizontal Merger Guidelines, para. 19.

²²⁸ The HHI is most useful to screen out mergers that do not raise competitive concerns but it cannot be used as a basis to prohibit a merger as this requires more sophisticated analysis. Whish & Bailey (2012), p. 44.

²²⁹ Whish & Bailey (2012), p. 42. There is a risk that the definition of the relevant market is done incorrectly e.g. if a distant substitute with large sales is either included or excluded while defining the relevant market. If the market cannot be defined in a manner that would be satisfactory it should not be relied upon but other methods such as econometric techniques should be used instead. Bengtsson et al. (2014), p. 691–692.

market is sufficiently easy, a merger is unlikely to pose any significant anti-competitive risk”) that can neutralise competition concerns on the market.²³⁰

In addition, despite the Commission’s ambiguous relationship with efficiency claims, particularly before the 2004 Merger Regulation and the adaptation of the SIEC test, the potential *efficiencies* produced by the merger are today also taken into account as a countervailing factor. If the Commission should assess that the efficiencies brought by the concentration outweigh the harm that it causes to competition, it can be cleared.²³¹ In this assessment the relevant benchmark is the welfare of consumers, who must benefit from the concentration (e.g. in the form of better or cheaper products), in order for efficiency claims to be accepted.²³² However, the Commission’s margin of discretion is limited, for instance when the merger would lead into the creation of a dominant position.²³³

Finally, even if according to the initial assessment of the concentration anti-competitive effects are likely, the Commission must take into account that according to the SIEC test it should be the *concentration* that is *causing* the impediment of competition. A merger should not be blocked even if competition is reduced in the market when it is estimated, that the prohibition of the transaction is followed by similar impediment of competition.²³⁴ The use of causality is not a novel concept in legal theory.²³⁵ However, causality has special relevance in the Commission’s appraisal of failing firm arguments, as *lack of causality* between the merger and the deterioration of competition is needed to be shown in order for the Commission to accept the failing firm defence.²³⁶

In order to deduce whether causality exists or not, the Commission has to look at two scenarios: (1) what would happen in the market if the merger took place, and (2) how would the competitive conditions evolve in the absence of the concentration. This comparison is known as *counterfactual analysis*, and it is used to find out the specific effects that the merger would have in comparison to changes that would take place even if

²³⁰ Horizontal Merger Guidelines, paras. 64, 68.

²³¹ Recital 29 of the Merger Regulation. See also Whish & Bailey (2012), p. 42. See also section 3.2.3. for the ambiguity regarding the acceptance of efficiencies.

²³² Horizontal Merger Guidelines, paras. 79–84. See also Bengtsson et al. (2014), p. 742. See also section 3.2.1. for further discussion on consumer welfare as a goal of EU merger control.

²³³ Cook & Kerse (2009), p. 266, 269; Whish & Bailey (2012), p. 875.

²³⁴ Horizontal Merger Guidelines, para. 89. See also Bengtsson et al. (2014), p. 733.

²³⁵ Kyprianides (2012), p. 576.

²³⁶ E.g. Kokkoris (2006), p. 496.

the merger did not take place.²³⁷ Normally counterfactual analysis is carried out between the pre-merger and post-merger market scenarios. The analysis involving a failing firm is different as the pre-merger market conditions are unlikely to prevail in the absence of the merger as one of the firms is exiting the market in any case. This is why counterfactual analysis in the case of a failing firm is carried out between the post-merger scenario and a scenario where the failing firm has exited the market.²³⁸

We are now concluding our review of EU merger control which has covered a range of topics beginning from the Treaty of Paris to the substantive assessment of failing firm arguments. EU merger control has developed from lacking a legal basis into a well-established system regulated by a set of legal provisions. This development has been affected both by the theories regarding competition law as well as the different, partly contradictory, goals that EU competition law and merger control are pursuing. Coincidentally the failing firm doctrine of the European Commission has gone through a similar development. The acceptance of the defence also began from an *ad hoc* decision of the Commission, which the ECJ subsequently confirmed. The requirements for accepting the failing firm defence are now established in the Horizontal Merger Guidelines of the Commission. We shall now turn our attention towards this development and assess how the competing theories and conflicting goals of merger control have affected it.

²³⁷ Horizontal Merger Guidelines, para. 9. See also Cook & Kerse (2009), p. 212–213; Bentsson et al. (2014), p. 688.

²³⁸ See e.g. Oinonen (2013) p. 13, Malinauskaite (2012). p. 312, Kokkoris (2006), p. 494. For a detailed discussion see Bavasso & Lindsay (2007).

4. Development of the Failing Firm Defence in EU Merger Control

Above, we have discussed the theories behind merger control as well as the main features of the merger control regime of the European Union. However, as we move on to examine the failing firm defence our point of view is converted. As already noted, the failing firm defence is actually directly at odds with the fundamental idea of merger control as it is used to clear mergers that have anti-competitive effects.

The parties invoking the failing firm defence are not trying to hide the fact that their transaction is likely to cause harm to competition. Instead, they argue that the competition authority is faced with a situation where the competitive structure is set to deteriorate in any case and that the acceptance of the transaction would actually cause less harm than the blocking of the merger.²³⁹

This section consists of three parts. First we shall take a look at the origins of the failing firm defence in the United States, which has influenced the development of the defence in EU merger control that is discussed in the second and third section of this Chapter. The aim is to draw a complete picture of this development both before and after the economic crisis in order to assess how the failing firm doctrine of the European Commission came to be and to detect possible changes in it brought by the recent economic turmoil.

4.1.Origins of the Failing Firm Defence

The formation of the basic principles of the failing firm defence doctrine can be tracked back to early antitrust enforcement in the United States. Although the doctrine has been later adopted in many different competition law jurisdictions, it reached EU merger control relatively late. This is probably why the theoretical basis of the failing firm doctrine in the EU is heavily influenced by US case law and legal literature.²⁴⁰ The relevant case law and theoretical considerations are introduced in this section.

The first cases in which the failing firm defence was applied in the United States did not explicitly stipulate what is the central yardstick against which the defence should be assessed. The early case law as well as the legal literature following it emphasised the social harms – unemployment and the loss of investments by shareholders – that would follow from bankruptcies caused by the denial of such transactions. These arguments

²³⁹ In comparison to countervailing factors such as efficiencies, the logic is very different. When the efficiency defence is invoked the parties argue that no harm to competition is caused because of the efficiencies produced by the merger. Oinonen (2013), p. 14.

²⁴⁰ See e.g. *ibid.* p. 2.

remained influential among legal scholars even after the US Supreme Court seemed to redefine its approach. Modern understanding of the defence is based more firmly on economic arguments as the approval of an anti-competitive concentration is seen dependent on whether, it causes less harm to competition, than its prohibition and the exit of the failing company's assets.²⁴¹

4.1.1. Early US Case Law Emphasised Social Aspects

*International Shoe*²⁴² is commonly regarded as the first case where a merger was accepted on the basis of the failing firm defence.²⁴³ In its judgment, the Supreme Court established two requirements which the parties had to show in order for the defence to be accepted: (1) the failing company should be facing severe financial difficulties, and (2) there should be no alternative purchaser for the failing firm's assets. These requirements remained unchanged for almost four decades until the Supreme Court further developed the doctrine in *Citizen Publishing*.²⁴⁴ This judgment added a third criterion which a merger should satisfy in order to be accepted on the basis of the defence: (3) the chances of restructuring the failing company through bankruptcy should be assessed unlikely.²⁴⁵

In *International Shoe*, the parties to the concentration, McElwain and International Shoe, were both shoe producers operating in the United States. McElwain ran into financial difficulties due to a general decrease in demand and was acquired by its much stronger competitor in 1921.²⁴⁶ After the compatibility of the acquisition with the Sherman Act was challenged, the matter ended up being decided by the Supreme Court, which approved the acquisition on the basis of what became known as the failing firm defence. The Supreme Court essentially reasoned that the other option being business failure creating losses to shareholders and unemployment to places where the company had plants, the acquisition of the company's shares by a competitor, that wishes to increase its capacity in order to satisfy the increasing demand, was preferable as there were no other potential buyers.²⁴⁷

²⁴¹ Oinonen (2013), p. 4–5.

²⁴² *International Shoe Co. v. Federal Trade Commission*. 280 U.S. 291, (1930).

²⁴³ See e.g. Baccaro (2004), p. 12; Paredes (1996), p. 350, 355.

²⁴⁴ *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969). See also Kaplan (1976), p. 660.

²⁴⁵ Paredes (1996), p. 352.

²⁴⁶ *International Shoe* (see supra note 242), at 299–301; Paredes (1996), p. 355.

²⁴⁷ “A corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure, with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser) not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser...”. Ibid. at 302.

Although the importance of the case to the development of the failing firm doctrine is undisputable, it has been questioned whether *International Shoe* was a failing firm case in the sense of the failing firm defence. Indeed, both critics and supporters of the defence have pointed out that the early case law was based on a different – more non-economic reasoning.²⁴⁸ *Kaplan* believes that the analysis of the effects of the acquisition was sidelined, as the Supreme Court was emphasising the interests of creditors, shareholders and the surrounding community of the failing company.²⁴⁹ *Paredes* notes that the Supreme Court considered these *private interests* only after it had concluded that the merger was not anti-competitive. He believes that the judgment has been misinterpreted as these interests did not have an impact on the Court's deliberation.²⁵⁰ However, *Paredes* also recognises an *economic rationale* in the Supreme Court's judgment although he does not agree with it. The acquisition and *International Shoe*'s motive for the purchase were not seen anti-competitive as *McElwain* was bound to exit the market, in which case the transaction was merely considered as a way to restore the failing firm's capacity on the market.²⁵¹

The US failing firm doctrine was further developed some 40 years later by the Supreme Court's judgment in *General Dynamics*.²⁵² *General Dynamics*, a deep mining coal producer, wished to acquire a strip-mining coal producer, *United Electric*, but the transaction was challenged as it did not meet the requirements of the failing firm defence established in earlier case law. As the Supreme Court noted, *United Electric* was a healthy company at the time of its acquisition, and there was no evidence suggesting that there would not have been alternative purchasers.²⁵³ However, the acquisition was cleared after the Supreme Court reformulated its interpretation of the failing firm defence:

“The failing company defense presupposes that the effect on competition and the loss to stockholders and injury to the communities where its plants were operated will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market. It is, in a sense, a “lesser of two evils” approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business.”²⁵⁴

²⁴⁸ Campbell (1984), p. 256

²⁴⁹ Kaplan (1976), p. 669.

²⁵⁰ Paredes (1996), p. 356–358. Similarly Baxter (1982), believes that there was no need for the Supreme Court to make any reference to the fact that *McElwain* was a failing firm as it had already accomplished that the merger was not causing the deterioration of competition, p. 249. See also Oinonen (2013), p. 4.

²⁵¹ Paredes (1996), is critical of this reasoning, as the buyer may be motivated instead of or in addition to efficiencies by the chance to increase market power, and keep the failing firm's assets away from the hands of other competitors or new entrants, p. 356–8, 362–364, 369. See also Oinonen (2013), p. 7–8.

²⁵² *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), at 507.

²⁵³ *Ibid.* at 508.

²⁵⁴ *Ibid.*

Essentially the transaction was approved even though United Electric was not a failing firm *per se* because “even if it remained in the market, it did not have sufficient reserves to compete effectively for long-term contracts”.²⁵⁵ The decision has been heavily criticised because it emphasised social considerations. Baxter has described the decision as a kind of “special government bailout” benefitting the interests of shareholders and employees of the company.²⁵⁶ Furthermore, unlike in *International Shoe* where competition did not deteriorate because of the transaction, in *General Dynamics* these social considerations or private interests were seen overcome competition concerns.²⁵⁷

The effect that economic theories concerning competition law and merger control have had on the development on the case law that created the failing firm defence, is somewhat difficult to estimate. During the time the Supreme Court was ruling on *International Shoe*, modern schools of thought had not yet emerged and the decision was based on more traditional thinking concerning market power: the acquisition could be cleared as it did not affect market structures since the merging parties were operating on separate markets. However, during the time when *General Dynamics* was ruled upon, Harvard School was having considerable influence on US antitrust law enforcement. Therefore, Harvard School could have had an influence on the reformulation of the failing firm defence. However, Harvard School’s outright disapproval of market concentration would have advised against the approval of failing firm arguments. Thus giving credit or criticism to Harvard School for the development of the early case law might be without basis. It is more likely that the early cases were influenced by the social and political surroundings more than competition law theories. These surroundings seemed to favour social considerations over economic ones.

4.1.2. Academic Debate over the Defence and a More Economic Reasoning

After *General Dynamics* the failing firm defence started to attract attention from legal and economic scholars. The early cases have faced a lot of criticism, but the defence has also been defended, by the likes of *Campbell* who is regarded as the first academic to have constructed a complete economic analysis of the defence.²⁵⁸ He did this by producing a series of economic models illustrating the efficiencies and positive effects on welfare the approval of the failing firm defence has. Campbell argued that under specific conditions,

²⁵⁵ *General Dynamics* (see supra note 252), at 509.

²⁵⁶ Baxter (1982), p. 248.

²⁵⁷ Paredes (1996), p. 557–560.

²⁵⁸ See e.g. Malinauskaite (2012), p. 311.

the acceptance of anti-competitive mergers could in fact be enhancing competition. He emphasised the importance of preserving aggregate capacity on the market which in turn would secure a lower price level, whereas the exit of the failing firm and decrease in overall capacity would harm consumers and the society as a whole by increasing market prices. Since maintaining the failing firm's production on the market is crucial from the perspective of economic efficiency, its acquisition by a company that is willing to maintain its production capacity on the market is preferable even if the buyer would be in a dominant position.²⁵⁹

Campbell argued that the assets of the failing firm should not leave the market as devoting them "to their next best use" would not be economically efficient.²⁶⁰ The opposite is true in the case of accepting the failing firm defence where the buyer is interested in acquiring the assets only because it expects the efficiencies and profits following from the acquisition to be greater than in the case of the exit of the failing firm's assets.²⁶¹

Campbell was ready to admit that the acquisition of a failing company would lead to a loss in economic efficiency if the following market structure resembled a monopoly.²⁶² In such circumstances, the dominant firm would not have the incentive to maintain the total output on the market, but would instead reduce production and lift prices causing a loss of economic efficiency. However, he strongly opposed labelling the failing firm defence inefficient because of this. Campbell noted that critics of the defence had failed to take into account that economic welfare and competition were going to be lost in any case, whether the rescue merger was accepted or not.²⁶³

McChesney – another prominent defender of the failing firm defence – went even further than this, as he believed that the acceptance of the defence would always be efficient. According to his thinking a dominant firm would not be interested of the merger unless it

²⁵⁹ In fact, the acquisition of a failing firm by a dominant firm would not have any negative effects on the competitive structure if the supply curve on the market would be horizontal as the dominant firm could not lift prices by restricting production because other companies on the market could increase their production. Moreover, Campbell argued that in specific circumstances allowing a failing firm to be acquired by a dominant company would always be efficient. In these markets the dominant firm would increase its production which would lower the market price. This would cause more economic surplus than in the case of the failing firm's exit from the market: without the acquisition total output would drop, market price would increase and economic surplus would reduce. Campbell (1984), p. 257–264; Malinauskaite (2012), p. 311.

²⁶⁰ If these resources could be used more efficiently in another market, the failing firm would have already transformed its line of production. Campbell (1984), 257.

²⁶¹ The buyer could also choose not to buy the assets of the failing firm in which case its profits would also increase as it could lift prices when the total production capacity is decreased. Oinonen (2013), p. 6.

²⁶² This would be the case if the demand curve on the market was residual i.e. price increases would not have an impact on the demand side.

²⁶³ Campbell (1984), p. 261–263.

was thinking that the transaction would lower its production costs, which in turn would be followed by an increase in output and in overall welfare. If a failing firm was to be allowed to exit, its assets would be lost while the remaining competitors would be able to lift their prices due to the increased demand they would be facing and the decreased overall capacity on the market. In other words, the result would be exactly the opposite than what antitrust legislation aims to ensure.²⁶⁴

However, the defence and its supporters have also been heavily criticised. *Oinonen* points out, that the absolute belief in keeping the assets in the market disregards the fact that most transactions do not actually produce efficiency gains. This is why the parties claiming that the approval of the defence would be efficient should produce evidence to back their claims. If efficiencies cannot to be shown to materialise, the post-merger scenario should be estimated so that the assets will exit the market regardless of the approval of the concentration. Moreover, blocking the merger might lead to remaining competitors dividing the assets of the failing firm more evenly between themselves, which is preferable compared to the situation where a single dominant firm would acquire the whole lot.²⁶⁵ This is why competition authorities should focus on the competitive structure of the market. The failing firm defence should not be accepted if the market structure would remain competitive after the failing firm's exit.²⁶⁶

Paredes fears that the overemphasis of exiting assets turns the failing firm defence into an *absolute* defence under which all transactions where the defence is invoked are accepted.²⁶⁷ This is particularly problematic when there is overcapacity in the market. In these situations the approval of the failing firm defence may distort competition by keeping an inefficient producer's assets on the market instead of reallocating them to markets, where they could be of more use.²⁶⁸

After its creation in US case law the failing firm defence has been both defended and opposed. The early case law faced criticism particularly because it included (social) goals

²⁶⁴ McChesney (1986). See also Oinonen (2013), p. 1, 3, 10; Malinauskaite (2012). p. 311.

²⁶⁵ Oinonen (2013), s. 7–8; Paredes (1996), p. 362, 365–367. Similarly Baxter (1982), does not believe that assets are likely to disappear following a bankruptcy but, on the contrary, they are likely continued to be used in production and employ roughly the same amount of people, p. 248–249.

²⁶⁶ The exit can actually increase competition when the remaining competitors attempt to gain the customers of the bankrupt firm. It is usually only the dominant firm that can purchase the failing firm's assets in their entirety whereas in the case of its exit each competitor could acquire those assets they value the most and the competitive structure would remain more even. Paredes (1996), p. 365–370.

²⁶⁷ Ibid. See also Oinonen (2013), p. 5–6.

²⁶⁸ Paredes (1996), p. 370–371, 378

outside the scope of antitrust law. Today, however, in general it is recognised by both scholars and competition authorities, that the acceptance of the defence can be preferable compared to the exit of the failing company at least under some circumstances. It is the nature of these circumstances and the importance given to different factors in the appraisal process of the merger that continues to be debated.

The reason why the defence is no longer opposed *per se*, might be the fact that because of the legal literature commenting the early case law, the failing firm defence developed into having a more economically sound reasoning behind it. As discussed in Chapter 3, economics has gradually gained more ground in competition law thinking. In relation to this, contemporary supporters of the failing firm defence tend to lean on the likes of Campbell as opposed to the reasoning of the Supreme Court in early US case law.

Campbell's reasoning clearly shows how the rationale behind the defence had moved on from social considerations into having a more economically sound basis. The fact that Campbell stresses the importance of efficiencies in the acceptance of the defence seems also to illustrate the influence of Chicago School in competition law theory. Campbell's emphasis of retaining the failing firm's assets on the market – which was not discussed in early case law – has influenced the later development of the doctrine also in the EU.

The critics of the failing firm defence, on the other hand, can be interpreted to oppose the oversimplifications of the Chicago School regarding efficiencies, as they have demanded that these efficiencies are actually proven. The critique can also be seen compatible with the effects-based approach demanding a case-by-case analysis of mergers: instead of just observing whether the assets of the failing firm would exit the market attention should be paid on how this would affect the overall capacity on the market. If the exit of the failing firm's assets is formalistically considered to be a reason to accept the defence this might lead to incorrect decisions if the overall capacity in the case at hand is not taken into consideration. These views may have affected the importance given to counterfactual analysis as opposed to the formal failing firm criteria in the failing firm doctrine of the EU the development of which we shall look into next.

4.2. Development of the Defence in EU merger Control before the Economic Crisis

Similarly as in the United States the failing firm defence became recognised in the merger control of the European Commission through case law. Although the US case law and the theoretical underpinnings following it have had an influence on the assessment of the

defence in the European Union, there are also noticeable differences in the way in which the failing firm doctrine has developed in these two jurisdictions.

First of all, the time frame, during which the failing firm defence has been assessed, has been very different. When in the 1990's EU merger control was taking its first steps with the concept of the failing firm defence, it had already become well-established in the United States.²⁶⁹ Partly due to its late arrival, there have not been as many cases in Europe where the failing firm defence has been invoked and even fewer of those in which the Commission has accepted the defence. As already mentioned, the Commission has faced criticism because of the "harsh" criteria it has set for the acceptance of the defence. However, it should be noted that the defence is not accepted particularly easily in the United States either.²⁷⁰

Secondly, the approach in US merger control has also been described as more formal – or *absolute* – in the sense that the acceptance of the defence is based on the fulfilment of formal conditions, whereas the Commission is willing to look at the actual effects the transaction will have on the competitive structure through counterfactual analysis even if the formal failing firm criteria would not be fulfilled.²⁷¹

4.2.1. *Kali and Salz: Criteria to Assess Causality*

The first time the European Commission encountered failing firm argumentation was in *Aerospatiale* in which aerospace companies Aerospatiale and Alenia were proposing to purchase Boeing De Havilland's regional aircraft division.²⁷² The transaction would have affected competition in three relevant markets one of which was the market of medium-size turbo-prop airplanes. In the market in question, the merged entity would have reached a market share of 64 per cent worldwide, and the Commission concluded that the concentration would have created a dominant position.²⁷³

The parties were arguing that in the absence of the transaction Boeing would be forced to shut down De Havilland. However, the Commission did not believe that De Havilland was actually failing. Moreover, the Commission argued that if De Havilland should exit the

²⁶⁹ Paredes (1996) notes that in mid-1990's there had been 12 occasions in which the Supreme Court had recognised the defence since *International Shoe*, p. 354.

²⁷⁰ See e.g. Baccaro (2004).

²⁷¹ See Oinonen (2013), who is in favour of this *relative* approach of the Commission, p. 18–20. See also Paredes (1996).

²⁷² *Aerospatiale* (see supra note 177), para. 5.

²⁷³ *Ibid.* paras. 28, 52.

market there would be other interested, and less dominant, buyers.²⁷⁴ According to it the “basic elements” of the defence – even though the elements themselves were not clearly outlined – were not satisfied.²⁷⁵ Also, the fact that De Havilland was a failing *division* instead of a failing *firm*, i.e. Boing was not failing in its entirety, might have made it more difficult for the Commission to accept the defence.²⁷⁶

Although the Commission was dealing with unfamiliar territory as similar argumentation had not been invoked in previous cases, the circumstances of the case seemed to make it fairly easy for the Commission to dismiss such claims without the need of outlining the specific conditions under which the failing firm defence could be accepted.

This was not the case in *Kali and Salz*²⁷⁷ where the Commission came to accept the defence for the first time. The case concerned a joint venture between Kali und Salz (K+S) and the Treuhandanstalt (Treuhand), which would have combined the potash and rock-salt activities of K+S and Mitteldeutsche Kali AG (MdK) owned by Treuhand. The Commission found that the transaction raised serious doubts as to its compatibility with the common market and initiated Phase II proceedings.²⁷⁸

The effects of the merger on competition in the relevant markets would have been undoubtedly negative. The Commission found that the merger would lead to a *de facto* monopoly on the German market for potash used for agricultural purposes.²⁷⁹ However, the parties argued the MdK was a failing firm – in fact, on the verge of bankruptcy due to the drop in sales after the collapse of Eastern European markets – and without the merger, MdK would disappear from the market, after which K+S would acquire its market share.²⁸⁰

The Commission was willing to consider this argument. According to its reasoning, although a merger leading to the creation or reinforcement of a dominant position would normally be prohibited this should not be the case when the competitive harm would also follow if the merger was prohibited, i.e. when the merger could not be seen to *cause* the deterioration of the competitive structure, which would take place in any case. Thus, the

²⁷⁴ *Aerospatiale* (see supra note 177), para. 31

²⁷⁵ Malinauskaite (2012), p. 308.

²⁷⁶ Kokkoris (2006), p. 498.

²⁷⁷ *Kali+Salz/MDK/Treuhaund* (see supra note 10).

²⁷⁸ Ibid. paras. 1–2.

²⁷⁹ In addition, the Commission came to the conclusion that K + S's takeover of MdK, the second-largest EC producer, will lead to the creation of a market-dominating duopoly on the Community market excluding Germany. However, the parties offered a number of commitments which lead the Commission to conclude that these concerns were removed. Ibid. paras. 46, 62–68.

²⁸⁰ Ibid. para. 70.

defence could be accepted if the parties could establish that it is not the concentration that is causing the creation or strengthening of a dominant position.²⁸¹ In order to estimate whether causality existed between the merger and the deterioration of the competitive structure the Commission formulated the initial criteria (*Kali and Salz criteria*) which the concentration should meet in order to be accepted in EC merger control:

- “a merger generally is not the cause of the deterioration of the competitive structure if it is clear that:
- the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking,
 - the acquiring undertaking would take over the market share of the acquired undertaking if it were forced out of the market,
 - there is no less anti-competitive alternative purchase”.²⁸²

The necessity of fulfilling these criteria – which is of particular interest in this thesis – was, however, left somewhat unclear as the Commission added that in a merger such as the case at hand, where the transaction would lead to the creation of a monopoly, “it is particularly important that the three conditions should be met”.²⁸³ This begs the question whether the conditions need to be met if the post-merger market structure contains other competitors.

The Commission found the parties’ submissions regarding MdK’s poor financial state believable and accepted the first criterion, as MdK would be forced to exit the market in the absence of the merger, following the collapse of Eastern European markets and German unification, which had caused a considerable collapse in its sales. The Commission did not demand that the exit should take place immediately if it could be expected “in the near future with a sufficient degree of probability”.²⁸⁴

The second Kali and Salz criterion dealt with the accrument of the failing firm’s market share by the acquirer. Again the parties were able to convince the Commission which deduced that as K+S would become the sole distributor in Germany it was very likely that it would inherit MdK’s market share after its exit from the market.²⁸⁵ The third criterion was also met as the parties were able to show that they had thoroughly searched an alternative purchaser. The Commission also noted that “no other undertaking could achieve the same synergies as K+S would be able to realize as purchaser of MdK”.²⁸⁶

²⁸¹ *Kali+Salz/MDK/Treuhaund* (see supra note 10), para. 71.

²⁸² *Ibid.*

²⁸³ *Ibid.*

²⁸⁴ *Ibid.* paras. 73–77.

²⁸⁵ *Ibid.* para. 78.

²⁸⁶ The parties demonstrated that a total of 48 firms worldwide had been approached from which 19 had expressed an interest in buying MdK. However, intensive talks had taken place with only three interested

Consequently, as the criteria, set out by the Commission to estimate whether there was a causal link between the merger and the harm caused to the competitive structure, were met, the Commission concluded that although after the transaction “a dominant position on the German market for agricultural potash will be strengthened...K+S’s dominant position would have been reinforced even in the absence of the merger”.²⁸⁷ Thus, the transaction was declared compatible with the common market.

However, the French Government was not pleased with the decision enabling a German company to become a monopolist in parts of the agricultural market of the European Community and it brought action against it, and so the legality of the failing firm defence became to be estimated by the ECJ. The French Government pleaded annulment of the Commission’s decision on four different grounds, one of them being the incorrect application of the failing firm defence. The French Government submitted that the defence originates from the United States and that the Commission had failed to take into account the same criteria as is applied in the US antitrust legislation, which would have been the only way to ensure the correct application of the doctrine.²⁸⁸ The Court of Justice denied the Government’s interpretation noting that although the Commission’s criteria differed from that of the ones used in the United States this in itself was not a ground to contest the validity of the decision. Furthermore, the Court found the criteria set by the Commission to be relevant and that the Commission had correctly appraised them in its decision.²⁸⁹

The Court also confirmed that the Commission’s notion regarding causality between the merger and deterioration of competition was correct. In fact, the ECJ’s interpretation of a rescue merger went even further than the Commission’s, as it held that the clearance of such a merger did not need to be better in terms of competition, but it was sufficient that

parties, one of them being K+S. The negotiations with the other two tenders did not go any further than the initial stage. *Kali+Salz/MDK/Treuhaund* (see supra note 10), para. 81. See also paras. 82–85.

²⁸⁷ Ibid. para. 95.

²⁸⁸ The French government noted that the Commission’s decision did not include criteria demanding that one of the parties to the concentration is in a position such that it will be unable to meet its obligations in the near future; and that this party is unable to reorganise successfully through bankruptcy. *France and Others* (see supra note 11), paras. 90–94.

²⁸⁹ Ibid. paras. 112–124.

the competitive structure would not deteriorate any further than in the absence of the concentration.²⁹⁰

Kali and Salz was an important case because of many reasons. First and foremost, it set a precedent on which European companies could rely, if their transaction was not causing the deterioration of the competitive structure which would take place also in the absence of the merger. Secondly, although the Commission applied the three criteria it set for the approval of the defence, the Commission held causality as the deciding factor while the criteria were formed to help estimate whether the transaction was causing the deterioration of competition. Essentially the Commission's decision regarding the acceptance of the defence was not dependent on the fulfilment of the formal criteria. This meant that the Commission was not following the formalistic approach of US merger control criticised by some for turning the defence *absolute*. However, neither the Commission nor the ECJ did perhaps stress this enough. It could be argued that some of the criticism the Commission has later received for applying an overly difficult test for rescue mergers follows from the confusion regarding the relationship between the "lack of causality" requirement and the formal criteria.²⁹¹

The Commission's and the ECJ's willingness to emphasise the "lack causality" as the basis for accepting a rescue merger can be considered remarkable and to some extent surprising. In the 1990's, the EU merger control was still being governed by the 1989 Merger Regulation and the dominance test. Under this test the Commission had been unwilling to accept efficiencies following from mergers. The approach that the Commission was applying was more formal as the creation or strengthening of a dominant position almost automatically meant that the concentration would be found incompatible with the common market. Hence, the approval of *Kali and Salz*, where the concentration was cleared even though a *de facto* monopoly market structure followed, was ground-breaking. It indicated the application of an effects-based approach, where the circumstances of the case at hand were taken into account, even though this approach was not fully adopted in EU merger control before the 2004 Merger Regulation.

²⁹⁰ *France and Others* (see supra note 11), paras. 110–116. See also See Commission Decision in *BASF/Eurodiol/Pantochim* (supra note 12), para. 139.

²⁹¹ Some writers have interpreted that rescue mergers have to pass both of these "tests". See e.g. Malinauskaite (2012) and Kyprianides (2012) who seem to interpret the Commission's decisional practice this way.

The approval of this merger and the market structure following from it also showed that the Commission was not relying on the thinking of Harvard School, which emphasised the importance of the structure and lack of concentration in the market. Instead it could be argued that the Commission had taken due notice of the theory concerning contestable markets. The Commission approved the transaction as the minimum efficient scale in the German potash market dictated that it could be operated profitably only by a single entity.

4.2.2. *Initial Approach towards the Failing Division Defence*

The approval of *Kali and Salz* did not lead to a string of similar clearances by the Commission. Instead, the Commission applied the criteria strictly especially in the cases of failing divisions.

The first case to follow was *Saint-Gobain* which concerned a joint venture – of a subsidiary of Saint-Gobain; Wacker-Chemie's subsidiary ESK; and NOM, a private investment and development company owned almost in its entirety by the Dutch Government – which would acquire the assets of ESK's Dutch subsidiary and its two German processing facilities dedicated to the silicon carbide business. All the parties were active in the production of a synthetic mineral called SiC, and the Commission found that the proposed joint venture would lead to the creation of a dominant position in the market for processed SiC. After performing the SSNIP test, the Commission found that "the parties will be in a position to impose a small but significant price increase, since the smaller competitors will not be in a position to challenge the parties, nor will potential competitors enter the market in the foreseeable future".²⁹²

The parties, however, argued that ESK's SiC business was in poor condition. The Commission approached this argument by referring to the *Kali and Salz* criteria which needed to be met in order to accept a transaction on the basis of the failing firm defence. Firstly, the Commission did not find it believable that ESK would exit from the SiC markets in the absence of the transaction. Secondly, it assessed that Saint-Gobain and other competitors would be incapable of answering to the increased demand following ESK's exit from the market, which would subsequently lead to a major price increase in the market. This would, however, attract new entrants on the market which could win over

²⁹² Case No IV/M.774 *Saint-Gobain/Wacker-Chemie/NOM*, Commission Decision of 4 December 1996, paras. 8, 220.

some of ESK's market share. The Commission estimated that even though Saint-Gobain would be able to acquire a major part of ESK's market share, it could not obtain *all* of it.²⁹³

Regarding alternative purchasers, the Commission came to the conclusion that the other German processing plant of ESK was "one of the most advanced SiC processing plants in the world, and could be sold either as a whole or in pieces to third parties", in which case it would remain in the market competing with Saint-Gobain. Not surprisingly, the Commission concluded that the joint venture was incompatible with the common market as effective competition would be significantly impeded.²⁹⁴

Although the European Commission did go through the *Kali and Salz* criteria, it can be argued that its decision regarding the acceptance of the rescue merger was based on the "lack of causality" requirement. The Commission applied the criteria in order to perform a counterfactual analysis comparing the deterioration of competition in scenarios following the acceptance and the denial of the merger. On the basis of this analysis the Commission concluded "that a prohibition of the merger would be the less anti-competitive decision".²⁹⁵

Kokkoris notes that the *Kali and Salz* criteria are very, or according to him, overly demanding which is why the parties could not achieve them in *Saint-Gobain*.²⁹⁶ It is relatively easy to agree with this notion, since the second *Kali and Salz* criterion regarding the accrument of the failing firm's *entire* market share seems too demanding, especially as it was shown that Saint-Gobain was in a position to acquire most of it. This probably had an effect on the Commission's decision to amend the criterion in question in its later decisional practice.²⁹⁷ However, as it was shown that the concentration did not meet the other criteria the Commission was able to reason that the approval of the merger would have been the more anti-competitive option.

The acceptability of the failing division defence arose for the first time after the approval of the failing firm defence in *Blokker/Toys'R'Us* when the Dutch Government requested the Commission to examine the transaction where Blokker proposed the purchase of its new rival's, Toys'R'Us', assets and inventory in the Netherlands.²⁹⁸ The Commission

²⁹³ *Saint-Gobain/Wacker-Chemie/NOM* (see supra note 292), paras. 247–254.

²⁹⁴ *Ibid.* paras. 259, 265.

²⁹⁵ *Ibid.* para. 247.

²⁹⁶ Kokkoris (2006), p. 499.

²⁹⁷ See section 4.2.3.

²⁹⁸ The Commission would not have had jurisdiction without the request as the parties' turnovers did not reach the relevant thresholds. Case No IV/M.890 *Blokker/Toys 'R' Us*, Commission Decision of 26 June

came to the conclusion that following a line of earlier acquisitions, Blokker already had a dominant position in the market for specialized toy retail outlets in the Netherlands. In addition to the increase in Blokker's market share, the transaction included a number of other harmful factors, such as the complementary nature of the Toys'R'Us' megastores to Blokker's other retail-stores which would have further strengthened Blokker's dominance on the market. However, Toys'R'Us invoked the failing firm defence arguing that its Dutch operations would close down without the merger with Blokker, there being no alternative less anti-competitive purchaser, in which case Blokker would gain its market share or at least most of it.²⁹⁹

The Commission began its review regarding these arguments by referring to its earlier decisions in which it had stressed the importance of the lack of causality between the merger and the creation or strengthening of a dominant position.³⁰⁰ After this it again moved on to assess the "lack of causality" by looking into to the *Kali and Salz* criteria.

The Commission did not believe Blokker would be able to gain all of Toys'R'Us' market share in the absence of the merger.³⁰¹ Nor was it convinced that there would not have been less anti-competitive buyers for Toys'R'Us' Dutch retail-stores. In fact, when considering Blokker's already high market share, the Commission argued, and not without merit, that Toys'R'Us had selected to sell its business to "the strongest player on the market". Toys'R'Us argued, that it had rejected buyers that did not have specific knowledge of the market or were potential competitors in other geographical markets. However, the Commission dismissed such claims as irrelevant.³⁰² The merger was found incompatible with the common market, which resulted in the rare decision of Commission ordering

1997, para 17. See also European Commission, *Press Release Blokker/Toys'R'Us*, http://europa.eu/rapid/press-release_IP-97-570_en.htm.

²⁹⁹ *Blokker/Toys 'R' Us* (supra note 298), paras. 82, 88, 108, 110.

³⁰⁰ *Ibid.* para. 111.

³⁰¹ Furthermore, the Commission noted that the increase in market share was not the only cause of concern in the case at hand. *Ibid.* para. 112.

³⁰² *Ibid.* para. 113.

Blokker to divest the assets, which it already had acquired from Toys'R'Us to an independent third party.³⁰³

The Commission went through the arguments of the parties regarding the fulfilment of *Kali and Salz* criteria somewhat briefly and seemed to base its decision especially on the unfulfilled alternative purchaser requirement. This is reasonable, as the existence of less anti-competitive buyers clearly means that blocking the merger is the pro-competitive decision. In fact, it is somewhat exceptional that merging parties should invoke the failing firm defence if any of the criteria is as obviously being left unsatisfied.

It appears that the parties had misinterpreted the probability of public intervention as the concentration was lacking a community dimension. After being caught red-handed following the referral of the case to the Commission, the parties were desperate to come up with an excuse to justify their anti-competitive transaction. Moreover, the parties might have misinterpreted the fairly new failing firm doctrine and presumed that the Commission was applying it much more leniently – the Commission had after all accepted a *de facto* monopoly on the basis of the defence. If this was the case, Toys'R'Us failed to recognize that MdK had desperately searched other less anti-competitive buyers which had persuaded the Commission to accept the defence.

The Commission, somewhat surprisingly, did not discuss the matter of failing *division* defence in its decision. This might have followed from the fact that its *Kali and Salz* decision, and the applicability of the failing firm defence in EU merger control, was at the time being reviewed by the ECJ and the Commission was waiting for the judgment before further elaborating its failing firm doctrine.

However, the Commission got the chance to deal with the matter shortly after being backed by the ECJ.³⁰⁴ The Commission developed its doctrine concerning the failing division defence further in *Bertelsmann*.³⁰⁵ The notified transaction concerned the German pay-TV supplier Premiere, which was owned by Bertelsmann's subsidiary CLT-UFA (37,5 %), Canal+ (37,5 %) and Kirch (25 %). The parties proposed that Canal+ would divest its shareholding, and that CLT-UFA and Kirch should increase their shares in Premiere to 50

³⁰³ European Commission, *Press Release Blokker/Toys'R'Us*, http://europa.eu/rapid/press-release_IP-97-570_en.htm.

³⁰⁴ See *France and Others* (supra note 11) discussed in section 4.2.1.

³⁰⁵ Case No IV/M.993 *Bertelsmann/Kirch/Premiere*, Commission Decision of 27 May 1998.

per cent each. Kirch would also transfer its digital pay-TV channel's assets to Premiere and place its pay-TV and pay-per-view rights at Premiere's disposal by sublicensing them.³⁰⁶

The transaction was considered to be problematic by the Commission for a multitude of reasons. Premiere and Kirch's DF 1 were basically the only pay-TV suppliers in Germany, and their merger would have led to Premiere having a near-monopoly as a pay-TV supplier. In addition to that, the conversion of Premiere into a joint venture between CLT-UFA and Kirch, and the termination of DF 1's independent pay-TV supplier activities would have meant that Premiere would have become the only pay-TV programme and marketing platform in Germany.³⁰⁷ Thus the Commission argued that the concentration would have led to the creation or strengthening of Premiere's dominant position on the pay-TV market in Germany.³⁰⁸

The parties tried to persuade the Commission by arguing along the lines of the *Kali and Salz* decision, that DF 1 had only enjoyed limited success so far and would otherwise be forced to close down, which is why competition would not be affected by the concentration, i.e. the transaction was not causing the creation or strengthening of a dominant position.³⁰⁹ The Commission was quick to point out that the case at hand differed from *Kali and Salz*, as DF 1 formed only a part of Kirch's pay-TV business and should be regarded as a failing division in which case

"particularly high standards must be set for establishing that the conditions for a defence on the grounds of lack of a causal link have been met. If this were not so, any concentration involving the disposal of an allegedly unprofitable area of a business could be justified for merger-control purposes by a declaration on the part of the seller that, without the merger, it would be necessary to close down the seller's business in that area".³¹⁰

In other words, the Commission did not deny the *possibility* of accepting the failing division defence but decided to set the bar for approving it even higher than in the case of a standard failing firm defence by demanding further credible proof of the lack of causality.

Much to the disappointment of the parties the Commission did not find that they would have reached this bar. Instead the Commission stated that "Kirch's abandonment of the pay-TV market is simply a management decision to give up an area of its business which

³⁰⁶ *Bertelsmann/Kirch/Premiere* (supra note 305), para. 8.

³⁰⁷ Moreover Premiere would have had access to unparalleled programme resources in Germany through its parent companies due to their position on the upstream markets for programme rights. Ibid. paras. 30–31, 35.

³⁰⁸ Ibid. para. 29.

³⁰⁹ Ibid. para. 70.

³¹⁰ Ibid. para. 71.

has not lived up to the management's expectations". The parties had referred to DF 1's initial losses which the Commission considered "insufficient to establish why DF 1 would have to cease trading".³¹¹ Thus, the first criterion was not met.

The Commission dealt with the failing division aspect of the transaction only while discussing the first criterion. This can be considered logical as an unprofitable division's exit is dependent on the management's willingness to keep funding it. The Commission seemed to place a high standard for the acceptance of the failing division defence, when requiring that the exit of the division must be caused by something more than the management's unmaterialized expectations regarding the division's profitability. Such an interpretation is not in line with the theory of contestable markets demanding that there are no exit barriers which the Commission seemed to have endorsed earlier in *Kali and Salz*.

The other *Kali and Salz* criteria were not satisfied either. The Commission was particularly disappointed with the "mere reference to Kirch's lack of success in identifying" other potentially interested partners, noting that it had set "stringent requirements for establishing that there is no possible alternative purchaser to the acquiring undertaking" in its *Kali and Salz* decision. Consequently, the concentration was declared incompatible with the common market.³¹²

In its earlier decisions, the Commission had treated the failure to meet the *Kali and Salz* conditions as evidence of a causal link between the merger and the deterioration of the competitive market structure. Although it expressed similar comments in the case at hand, the Commission added that "even if Kirch terminated DF 1's operations the negative effects on competition would be less severe" as this would "enable competing pay-TV organisations to acquire Kirch's pay-TV distribution rights and enter the pay-TV market in competition with Premiere".³¹³

In other words, the Commission pointed out that the counterfactual scenario where the failing company or division in this case would exit the market, would be better in terms of competition than the approval of the transaction. Although this appears to be compatible with the Commission's earlier decisions, it might have confused some to think that the

³¹¹ *Bertelsmann/Kirch/Premiere* (supra note 305), paras. 71–73.

³¹² The Commission wished more detailed information including the parties with whom negotiations had taken place and the reasons for their failure. *Ibid.* paras. 74–75, 156.

³¹³ *Ibid.* para. 76.

parties invoking the failing firm defence have to fulfil both the formal criteria set in the *Kali and Salz* decision as well as the “lack of causality” requirement that is assessed with the use of counterfactual analysis. As stated above, it is argued here, however, that both the formal criteria and the “lack of causality” requirement are two pieces of the same assessment, in which the former is used as a “proxy” to estimate whether the latter – on the basis of which the decision regarding the acceptance of the rescue merger is made – is satisfied. This decision, where these two pieces were discussed separately, in a way offered a glimpse of what was to come in relation to the question of whether the Commission regards the fulfilment of the formal criteria always necessary for the clearance of rescue mergers.³¹⁴

The following failing division cases kept hitting the same wall as *Bertelsmann* had done. In *Rewe/Meinl* Rewe Group proposed the acquisition of Julius Meinl which, together with its subsidiaries, owned a total of 341 shops, including supermarkets, discount stores, hypermarkets, and a chain of delicatessens, in Austria. Rewe’s subsidiary Billa was already the market leader in Austrian food-retailing.³¹⁵

In its competitive assessment, the Commission came to the conclusion that pretty much everything – from the location of the shops to the management of the chains – was in favour of the merging entity and hence would only increase its market share in the future. The parties replied to the concerns by invoking the failing firm defence.³¹⁶

Again, the Commission began its appraisal regarding the defence by acknowledging that the *Kali and Salz* criteria were needed to be met in order to establish that merger was not the cause of the deterioration of the competitive structure. And again, as in *Bertelsmann*, the Commission noted that the case at hand was actually dealing with the failing division defence, as Meinl’s retailing division accounted only a part of its business activities and subsidiaries. The Commission used the same wording as in *Bertelsmann* to underline that because of this the parties faced a heavier burden of proof in establishing the “lack of causality” requirement as Meinl’s retailing division’s exit from the market should not be merely a “management decision”.³¹⁷

³¹⁴ This includes rescue mergers where the failing firm defence is not specifically invoked, see section 4.2.3.

³¹⁵ Case No IV/M.1221 *Rewe/Meinl*, Commission Decision of 3 February 1999, paras. 4, 6.

³¹⁶ *Ibid.* paras. 60–62.

³¹⁷ *Ibid.* paras. 63, 65.

In *Rewe/Meinl* the Commission specified how it estimates the first criterion, the failing firm's exit from the market. The Commission noted, that whilst it was true that Meinl's financial situation had deteriorated in recent years, the parties did not submit "any evidence to suggest that Meinl is already, or is about to become, insolvent".³¹⁸ In *Kali and Salz*, the Commission had not demanded that insolvency proceedings would have been underway or looming in the very imminent future, as MdK's closure was very probable.³¹⁹ In *Rewe/Meinl* the Commission may have wished to clarify the importance of near insolvency as a sign of the failing firm's likely exit.

Regarding the second and the third criteria the Commission also found the parties' admissions insufficient and contradictory. The parties had claimed that Spar was the only alternative buyer, and as it held a similar market share as Rewe/Billa, it could not be a less harmful purchaser. However, the Commission used this reasoning to point out that Rewe/Billa would not be able to absorb Meinl's entire market share as Spar would be in a similar position to compete from it after Meinl's exit. Additionally, the parties' had failed to produce evidence regarding the negotiations with other potential buyer candidates.³²⁰ Consequently, the parties had to offer the Commission commitments according to which Rewe/Billa would cease to continue the operation of Meinl shops as food-retailing outlets in areas where competition concerns were detected by the Commission in order to get the merger declared compatible with the common market.³²¹

In the cases following the initial acceptance of the failing firm defence, the Commission continued to apply the criteria it had set in *Kali and Salz*. With the exception of its decision in *Bertelsmann*, the Commission deduced whether there existed a causal link between the merger and the deterioration of the competitive structure purely on the basis of fulfilment of these criteria. In none of these cases were the parties able to show that the criteria would have been met, which led the Commission to deny the acceptance of the defence.

The cases also offered the Commission an opportunity to clarify its approach towards the failing division defence. *Baccaro* suggests that the "lack of causality" requirement could actually be considered as a separate fourth criterion placed on the parties pursuing the failing *division* defence. If this was the case, the Commission's interpretation of the failing

³¹⁸ *Rewe/Meinl* (see supra note 315), para. 66.

³¹⁹ *Kali/Mdk/Treuhaund* (supra note 10), see e.g. para. 71.

³²⁰ *Rewe/Meinl* (see supra note 315), para. 62, 67–68.

³²¹ *Ibid.* para. 118.

division defence would resemble that of the US merger control's where the defence is more firmly established.³²²

However, it could be argued that the Commission has rather consistently – ever since of its *Kali and Salz* decision – insisted that this requirement must be fulfilled also in the case of failing firms.³²³ Instead, the Commission has demanded that in the case of a failing division defence the fulfilment of this requirement needs to be shown even more clearly. More importantly, the Commission set the bar for accepting the fulfilment of the first *Kali and Salz* criterion very high by demanding that the decision to close down the operations of the division cannot be based on unfulfilled expectations regarding the division's profitability. This differed from the Commission's approach in *Kali and Salz* where it seemed to endorse the theory of contestable markets.³²⁴ Instead the Commission's initial approach towards the failing division defence was more in line with ordoliberalism and the avoidance of monopolistic market structures. This goes to show that the Commission has not followed a single theory when developing its approach towards failing firm and division arguments.

4.2.3. *Formal Criteria is Reformulated but Sidelined by Counterfactual Analysis?*

After approving the failing firm defence in *Kali and Salz*, the European Commission had interpreted the defence strictly. During the 1990's no other transaction was able to satisfy the stringent criteria set by the Commission for the appraisal of failing firm arguments. However, in 2001 the Commission's decision in *BASF/Eurodiol/Pantochim* turned out to be significant in further developing the interpretation on how rescue mergers should be assessed in EU merger control.³²⁵

The case concerned the acquisition of sole control over two chemical production companies, Eurodiol and Pantochim, by BASF, which had world-wide activities in the production and distribution of chemicals. The transaction gave rise to competitive concerns in several markets – including the combination of the only producers of certain chemicals in the EEA – and the Commission assessed that it was likely to lead to the creation of a dominant position. BASF replied to these concerns by invoking the failing firm defence

³²² Baccaro (2004), p. 12, 15–16.

³²³ The Commission later confirmed in its Horizontal Guidelines that this “basic requirement” indeed is applicable also in the case of failing firms. See section 4.2.4.

³²⁴ According to the theory of contestable markets the Commission's interpretation of the failing division defence should have decreased the willingness of companies to enter into risky markets as their chances of exiting from them were uncertain.

³²⁵ *BASF/Eurodiol/Pantochim* (see supra note 12).

noting that it would gain a comparable position even in the absence of the merger, and that in any event the assets of the businesses in question would exit the market.³²⁶

As the Commission moved on to assess these claims it found that only two out of the three original *Kali and Salz* criteria were suitable for assessment of the defence in the case at hand. The merging parties should still show that the failing company would in the near future be forced out of the market without the transaction and that there is no less anti-competitive alternative purchaser for the firm. However, the criterion demanding the accrument of the failing firm's market share was ill-suited, since BASF was not becoming a monopolist following the transaction and it was not going to gain *all* of Eurodiol's and Pantochim's market share.³²⁷

The Commission explained the relevance of what would become the new third criterion by noting that the application of the first two criteria does not rule out the possibility that the assets of the failing firm could return to the relevant market following the company's bankruptcy if acquired by other competitors operating on the market. According to the Commission in such a situation "the economic effects would be similar to a take-over of the failing firms themselves by an alternative purchaser" and that "it needs to be established in addition to the first two criteria, that the assets to be purchased would inevitably disappear from the market in the absence of the merger".³²⁸ Following this reasoning, the Commission presented its new formulation of the failing firm criteria:

“(a) the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking,
(b) there is no less anti-competitive alternative purchase, and
(c) the assets to be acquired would inevitably exit the market if not taken over by another undertaking.”³²⁹

In the case at hand, the Commission was ready to accept that the first criterion was met as both Eurodiol and Pantochim had been placed under a pre-bankruptcy regime. Similarly, a suitable buyer for the assets of Eurodiol and Pantochim had already been searched during the pre-bankruptcy period, but apart from BASF no viable offers had been submitted, which was sufficient for establishing that the second criterion was met.³³⁰

³²⁶ *BASF/Eurodiol/Pantochim* (see supra note 12), paras. 3–7, 63, 70, 78, 110, 118, 134–135.

³²⁷ *Ibid.* paras. 140, 150–152.

³²⁸ *Ibid.* para. 141.

³²⁹ *Ibid.* para. 142.

³³⁰ Nevertheless, to exclude any doubt regarding the existence of an alternative purchaser, the Commission further inquired whether there were other interested buyers. *Ibid.* paras. 144–148.

The newly formulated third criterion was also fulfilled, as the Commission believed that there would not have been other suitable candidates to take on the costly and environmentally risky production of Eurodiol's and Pantochim's plants. According to the Commission the exit of the companies' assets following from the blocking of the transaction "most probably" would have lead "to a considerable deterioration of market conditions, to the disadvantage of the customers".³³¹

The rationality behind the third criterion was emphasised even as the Commission moved on to its counterfactual analysis – which the Commission now decided to perform, even after it had concluded that the formal failing firm criteria were met. The Commission found that the exit of the failing companies' production capacities from the market would have caused "a significant capacity shortage for products" which already were offered on the market "under very tight capacity constraints", as the remaining competitors would not have been able to increase their production to meet the increased demand. The capacity constraints combined to the inelastic demand on the market led the Commission to conclude that there would have been a significant price increase if the merger was blocked and the assets of these firms exited the market. Because of these reasons, the Commission came to conclude that "the market conditions would be more favourable for the customers after the merger".³³²

The amendment of the third criterion can be seen reasonable as the market share criterion set in *Kali and Salz* had been mostly suitable for mergers where the market structure was changing from a duopoly to a monopoly. In a market, where there are more competitors, it would be very hard for the purchaser to show that it would be able to gain the entire market share of the failing firm in the absence of the merger.³³³ In addition to that, the renewed third criterion was more adapted to take into account the overall capacity of the market and the effects that the failing firm's exit could have on market prices.

The inclusion of this criterion is strongly advocated by the likes of *Campbell*, who consider that such a criterion is needed for preserving the overall capacity on the market and to impede price increases. And while scholars such as *Paredes* might be critical of the emphasis placed on the exit of the failing company's assets, they would be pleased that the Commission continued to perform a counterfactual analysis even after it was shown that

³³¹ *BASF/Eurodiol/Pantochim* (see supra note 12), paras. 151–156.

³³² *Ibid.* paras. 157–162.

³³³ See e.g. *Saint-Gobain/Wacker-Chemie/NOM* (see supra note 292).

the formal failing firm criteria was met.³³⁴ This goes to show that the Commission's application of the failing firm doctrine is not absolute, as it was ready to consider whether the clearance of the merger actually was less anti-competitive than its blocking. Essentially this means that the Commission would also be ready to block a merger even if the transaction satisfied the formal failing firm criteria.

After assessing – and dismissing – failing firm argumentation in several cases since its decision in *Kali and Salz* the Commission's decision to approve a problematic transaction on the basis of the failing firm defence did not cause as much bewilderment as perhaps the initial acceptance of the defence. The earlier decisional practice may have removed any doubt on whether parties could trick the Commission to clear anti-competitive mergers. Nevertheless the clearance of *BASF/Eurodiol/Pantochim* was exceptional as the merger combined the only producers of certain chemicals in the EEA. Similarly to *Kali and Salz* the Commission again accepted the creation of a monopolistic market structure as the deterioration of competition was not caused by the merger. Again this is compatible with the theory of contestable markets according to which such a market structure is not problematic as new entrants can emerge if the monopolist should raise its prices above competitive level.

After *BASF/Eurodiol/Pantochim*, the Commission got a chance to test the revised criteria in the context of a failing division in *Newscorp/Telepiu*.³³⁵ The case concerned the Italian pay-TV market, where the global media company Newscorp was hoping to acquire the sole control over two Italian pay-TV platforms, Telepiu and Stream, and combine the businesses of the two companies.³³⁶ The problem, according to the Commission, was that Telepiu already enjoyed a dominant position on the market with a considerable market share, while Stream was its only real contender.³³⁷ If Newscorp had acquired the two companies there would have been “virtually no competition left” and the merger would have created a near-monopoly on the Italian the pay-TV market.³³⁸

³³⁴ However, *Kyprianides* (2012) believes that the Commission added an extra stage to the appraisal process of rescue mergers: the concentration should satisfy the three formal criteria after which the parties should show that the competitive structure would not be worse than in the case of blocking the merger, p. 580.

³³⁵ Case No COMP/M.2876 *Newscorp/Telepiu*, Commission Decision of 2 April 2003.

³³⁶ Ibid. paras. 7–10.

³³⁷ In 2001 Telepiu's market share was between 60–75 per cent while Stream's market share ranged somewhere between 25–40 per cent. Ibid. paras. 79–81, 180.

³³⁸ What made matters worse was that the pay-TV platforms did not witness competitive constraints from Italian cable operators. Ibid. paras. 103, 114.

Newscorp argued that the failing firm defence could be applied, as without the merger Stream's assets would exit the market and Telepiu would inherit its market share. Newscorp was claiming, that it was forced to close down Stream in the absence of the merger as the company could not become profitable on its own, and shutting down its operations would become cheaper to its parent companies than continuing them.³³⁹

The Commission noted that Stream was in fact partly owned by two companies, Telekom Italia and Newscorp, the latter of which wished to gain sole control of it and merge it with Telepiu. The Commission referred to its decision in *Rewe/Meinl* to point out that the parties were actually invoking the failing division defence.³⁴⁰ However, the Commission noted a peculiarity in the parties' argument and added that proving the lack of causality is even more important, if the failing division is *already partly owned* by the acquiring company as it "might have strategic reasons to keep its failing division alive even if the merger were to be prohibited". Because of this the Commission found that Stream's exit from the Italian pay-TV market would be "a management decision to abandon a business activity" which had not "lived up to the expectations" of its managers.³⁴¹

The second criterion was not met either because of similar reasons as in *Rewe/Meinl* and *Bertelsmann*: the parties were not able to show that they had negotiated with other potential buyer candidates, nor the reasons for the failure of the negotiations. As for the third requirement, the Commission decided that it did not have to reach a conclusion on the matter, as the transaction had already failed to meet the first and the second criterion.³⁴²

This can be considered somewhat surprising, as the Commission had not taken such "shortcuts" before in its appraisal of the failing firm defence. However, the decision not to assess the third criterion might have been affected by fact that Newscorp had invoked the defence very late in the process.³⁴³ This might have left the Commission suspicious of the parties' argument and furthermore the Commission only had a limited amount of time to go through the argument thoroughly. Thus, it can be argued that the Commission was not setting up a precedent but rather was struggling to meet the deadline to give its decision.

³³⁹ *Newscorp/Telepiu* (supra note 335), paras. 210, 213.

³⁴⁰ The parties should prove the lack of causality between the transaction and the impediment to competition. Again the Commission added that otherwise "every merger involving an allegedly unprofitable division could be justified under merger control law by the declaration that, without the merger, the division would cease to operate". Ibid. paras. 211–212.

³⁴¹ Ibid. paras. 312, 214.

³⁴² Ibid. paras. 217, 220.

³⁴³ Ibid. para. 215.

In the end, the Commission approved the merger with commitments that were set to ease entry barriers.³⁴⁴ *Baccaro* believes that the decision represented a newly developed appraisal of the failing firm defence, which now rested on a more economic and less legalistic footing as the Commission was more willing to place emphasis on its counterfactual analysis. He interprets, that although the Commission did not become convinced of the lack of causality between the merger and the detriment caused to the competitive structure, as the merger did not meet the revised criteria, it was still willing to avoid a “worse counterfactual”, which would have followed from the blocking of the merger.³⁴⁵ *Kyprianides* agrees with this interpretation: after estimating the scenario where Stream would have exited the market, the Commission found the approval of the merger along with the relevant remedies to be more beneficial to the consumers.³⁴⁶ This is a somewhat bold interpretation, as the Commission makes no reference to a possible worse counterfactual in its decision. However, it is consistent with the decisional practice of the Commission that followed.

A similar formula for clearing mergers on the basis of counterfactual analysis was perhaps even more clearly adopted in the *Andersen* cases.³⁴⁷ Following the Enron scandal, Arthur Andersen’s, which had acted as Enron’s auditor, reputation was damaged so severely that it would have been impossible for it to continue its international practices. Therefore most of the national Andersen companies were seeking to merge with other “Big Five” accounting houses.³⁴⁸

In Europe, three of these mergers came under the scrutiny of the European Commission. Failing firm arguments were not formally invoked in any of them, nor did the Commission appraise whether the revised failing firm criteria would have been met. However, the Commission found that the lack of causality between the mergers and the deterioration of competition could be shown even without resorting to the formal failing firm criteria. The

³⁴⁴ *Newscorp/Telepiu’* (supra note 335), paras. 221–228.

³⁴⁵ *Baccaro* (2004), p. 18–23.

³⁴⁶ *Kyprianides* (2012), p. 580.

³⁴⁷ Case No COMP/M.2810 *Deloitte&Touche/Andersen UK*, Commission Decision of 1 July 2002, Case No COMP/M.2824 *Ernst&Young/Andersen Germany*, Commission Decision of 27 August 2002 and Case No COMP/M.2816 *Ernst&Young/Andersen France*, Commission Decision of 5 September 2002.

See also Case No COMP/M.5141 *KLM/Martinair*, Commission Decision of 17 December 2008 where the defence was not addressed either but the transaction was cleared following a counterfactual analysis which showed that the competitive constraints the companies had on each would be removed also in the absence of the merger. See also similar decisions in Case No COMP/M.6447 *IAG/bmi*, Commission Decision of 30 March 2012 and Case No COMP/M.257 *Pirelli/Edizione/Olivetti/Telecom Italia*, Commission Decision 20 September 2001.

³⁴⁸ See e.g. *Baccaro* (2004), p. 21. Following Andersen’s exit the group was reduced to “Big Four”.

Commission became convinced that the remaining competitors were going to divide up the businesses of the Andersen enterprise whether the mergers were accepted or not, as there were no potential entrants to the market.³⁴⁹ In other words, lack of causality was met as the counterfactual scenarios did not produce any better outcomes in terms of competition than the approval of the transactions.³⁵⁰ In fact, the counterfactual analysis showed that blocking the mergers would lead to a more heightened risk for collective dominance because of the oligopolistic market structure.³⁵¹

According to *Baccaro* the *Andersen* decisions represented a newly discovered readiness by the Commission to come up with pragmatic solutions to cases where the application of the failing firm defence would have been impractical due to the failure of meeting the formal criteria. Arthur Andersen was not a failing firm because of its financial condition, but was in any case, going to exit the market rapidly. If the fulfilment of the first criterion was uncertain, the third criterion regarding the assets of Andersen would not have been met in any case as the skilled labour of the Andersen companies would have been employed by the other firms in the market.³⁵² The Commission did not want the employees of Andersen to be evenly divided between the competitors as this would have increased the likelihood of coordination. This is why accepting the concentration was the less harmful option in terms of competition.³⁵³

In 2007, the Commission followed this practice in *JCI/Fiamm* in which VB, the automotive battery joint venture of JCI and Bosch, was seeking the acquisition of sole control over Fiamm's automotive starter battery business, Fiamm SBB.³⁵⁴ Following a very detailed analysis of the relevant product and geographical markets, the Commission came to the conclusion that the merger would create a dominant position on the Slovak independent aftermarket for car and starter batteries, and as a result it would significantly impede effective competition in the common market.³⁵⁵

The parties invoked the failing firm defence on the basis of Fiamm's lack of available funding which would have led to its insolvency in the absence of the merger. The

³⁴⁹ *Deloitte&Touche/Andersen UK* (supra note 347), paras. 44–47, 49–61; *Ernst&Young/Andersen France* (supra note 347), paras. 75, 78, 80–90. See also *Baccaro* (2004), p. 19–20.

³⁵⁰ Kyprianides (2012), p. 577.

³⁵¹ See, e.g. *Deloitte&Touche/Andersen UK* (supra note 347), para. 65.

³⁵² *Baccaro* (2004), p. 20.

³⁵³ See OECD (2009), where the Commission explains its reasoning, p. 186–187.

³⁵⁴ Case No COMP/M.4381 *JCI/Fiamm*, Commission Decision of 10 May 2007, paras. 17–22.

³⁵⁵ *Ibid.* para. 688.

Commission considered Fiamm's bankruptcy and exit from the market to be indeed very likely without the sale of its SBB division. Additionally, the parties were able to persuade the Commission to believe that although Fiamm's search for and negotiations with alternative buyer candidates had been limited this was heavily affected by the imminence of the insolvency proceedings and the fact that the other competitors could not actually be regarded as *potential* buyers due to their much smaller size. Therefore, the second failing firm criterion was also accepted. However, the third criterion regarding the exit of all of Fiamm's assets was not met as the Commission found that although the SBB division would be closed following a bankruptcy, its individual assets would not "necessarily" exit as they could be purchased and brought back to the market by the smaller producers operating on the market and by JCI.³⁵⁶

However, after dismissing the fulfilment of the formal failing firm criteria, the Commission stated that the "overall criterion" for assessing the compatibility of a rescue merger with the common market was "whether the proposed transaction has to be considered to be the cause of the significant impediment of effective competition" which was to be estimated by comparing the "merger scenario" with the "liquidation or failed-firm scenario". Furthermore, the Commission added that "even if not all of the three criteria regarded as especially relevant for the assessment of the 'failing firm defence' are satisfied, the Commission has to take due account of the concrete likelihood that FIAMM would enter into one of the liquidation procedures if the merger does not go through, and therefore has to assess the effects of such liquidation in the context of the appropriate merger counterfactual". In the case at hand, the counterfactual scenarios did not prove to be as harmful in terms of deterioration of the competitive structure as the merger scenario – and therefore there existed a "causal link between the proposed concentration and the adverse effect on competition" – but the transaction could be approved through remedies.³⁵⁷

The case showcased that the formal failing firm criteria, although having been reformulated in *BASF/Eurodiol/Pantochim*, still proved difficult to satisfy. Indeed, the third criterion requiring the exit of *all* of the failing firm's assets has been estimated to be overly difficult, as will be discussed in the following section. More importantly, the case

³⁵⁶ *JCI/Fiamm* (supra note 354), paras. 720–721, 733–736, 749–750.

³⁵⁷ According to the Commission the competitive harm following from the transaction would have been structural in nature whereas the negative effects following from liquidation would have been short term. *Ibid.* paras. 751, 814–816, 912.

highlighted that “the lack of causality” was indeed the “overall criterion”, and that rescue mergers could be approved even if they did not fulfil all the conditions of the formal failing firm defence.

Not everyone agreed with the logic of this decision. *Malinauskaite* argues that it is confusing in terms of legal certainty if rescue mergers are accepted even though they do not meet the formal conditions stipulated by the Commission. The relevance of the criteria can be questioned if they are not needed to be met and parties to future transactions might not have the incentive to invoke the defence if the merger can be accepted purely on the basis of a counterfactual analysis.³⁵⁸ *Oinonen* agrees by noting that, because of the strict application of the failing firm criteria it might be more rational for the parties to invoke just the counterfactual analysis without resorting to failing firm argumentation, especially if one or more of the failing firm criteria are likely to be left unfulfilled.³⁵⁹

I believe that the decision clarified the relationship between the overall criterion (lack of causality), and the formal three criteria developed in the previous Commission decisions regarding the failing firm defence. The Commission had now accepted that even if the lack of causality is not shown through the fulfillment of the formal criteria, it can still be shown following a counterfactual analysis. This was not completely consistent with the decisional practice following the *Kali and Salz* decision where the “lack of causality” requirement had been assessed through the satisfaction of the criteria. However, the Commission was given the chance to clarify its position in the Horizontal Merger Guidelines where the failing firm defence was to be addressed.

4.2.4. *Horizontal Merger Guidelines: Formal Criteria and the Basic Requirement*

As previously discussed, the 2004 Merger Regulation was accompanied by the Horizontal Merger Guidelines set to clarify the Commission’s appraisal process under the SIEC test.³⁶⁰ Although the Guidelines are not binding, they are valuable in clarifying the Commission’s interpretation of the Merger Regulation and the appraisal of concentrations. The Horizontal Merger Guidelines are even more relevant when dealing with the failing firm defence which is not addressed in the Regulation itself. The companies hoping to rely on the defence do not need to solely look at earlier decisions in order to estimate whether their transaction can be cleared, as the way in which the Commission assesses the failing

³⁵⁸ Malinauskaite (2012), p. 315–316. See also Perpiñà (2015) who, however, is not criticising this, p. 108.

³⁵⁹ Oinonen (2013), p. 16.

³⁶⁰ See section 3.1.3.

firm defence is expressed now in the Guidelines.³⁶¹ Paragraph 90 of the Guidelines states that the “Commission considers the following three criteria to be especially relevant for the application of a ‘failing firm defence’”. These criteria are discussed here in detail.

According to the first criterion, “the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking”.³⁶² This criterion has remained fairly similar since its introduction in *Kali and Salz*, and its logic is similar to that of early US antitrust enforcement: the defence should be used only when the target company is actually on the verge of exit from the market. The Commission has not – and perhaps cannot – place a specific threshold which would pinpoint the financial agony needed to be met in order to satisfy this criterion. Instead, the assessment of this criterion takes place on a case-by-case basis.³⁶³ The Commission has not required that the bankruptcy proceedings should be underway at the time of the notification, but they must be imminent.³⁶⁴ Although not specified in the wording of the criterion, the Commission interprets it broadly. Not only is the failing company’s financial condition under scrutiny, but the livelihood of the industry, in which it operates, is also taken into account as well as the chances of structural reorganisation of the failing firm.³⁶⁵

The first criterion is widely accepted among legal scholars, as the financial difficulties of the failing firm form the basis of the defence. It can also be considered to be more “certain” than the two other, more hypothetical, criteria.³⁶⁶ However, this criterion can be difficult for the parties to prove especially during an economic crisis when a failing company’s financial troubles can be confused with the general fall in market demand.³⁶⁷

³⁶¹ Horizontal Merger Guidelines, paras. 89–91.

³⁶² Ibid. para. 90.

³⁶³ Malinauskaite (2012), p. 310; OECD (2009), p. 183–184. Oxera (2009) has recognized profitability, liquidity and solvency as the metrics used by the Commission to estimate the financial condition of the failing company.

³⁶⁴ See *Kali and Salz* (supra note 10), para. 71. The failing firm must be genuinely close to bankruptcy which is to follow if the merger is not accepted. If “flailing” firms were to be given the permission to be “rescued” companies might have a temptation to pretend to be less-profitable. Kokkoris (2006), p. 494, 509.

³⁶⁵ *BASF/Eurodiol/Pantochim* (supra note 12), paras. 144–146. See also Perpiñà (2015), p. 106; Oinonen (2013), p. 9; OECD (2009), p. 183–184. Parades (1996) notes that the failing firm’s inability to be reorganised should not solely be regarded as evidence of an unproblematic merger as this does not prevent the purchaser’s ability to exploit the procured assets and cause anti-competitive effects, p. 376–378, 380–382.

³⁶⁶ Perpiñà (2015), who, however is somewhat critical of the assumption that having a financially unstable company on the market is always better for consumers whereas the acceptance of its acquisition is likely to lead to higher prices, p. 106.

³⁶⁷ Malinauskaite (2012), p. 310. See section 4.3.2 as this confusion seems to have played a role in the *Aegean/Olympic* saga.

The second criterion of the Horizontal Guidelines requires that “there is no less anti-competitive alternative purchase than the notified merger”.³⁶⁸ The Commission will compare the market structure of the post-merger scenario with market structures that would follow in the case of other purchasers. The purpose is to establish whether there are other potential acquirers with whom the transaction would prove less problematic in terms of competitive harm. The parties should be able to show that they have done everything at their disposal to find less harmful buyer candidates, who have been given the opportunity to negotiate over the acquisition of the failing firm. In addition to that, all offers above the liquidation value should be taken into account, while the efficiencies that would follow from the transactions with different buyers should be used in deciding which of the offers is the least harmful to competition. During an economic crisis, this criterion might prove easier for the parties to establish, as there is likely to be less enthusiasm to buy failing businesses.³⁶⁹ Nonetheless, Kaplan criticises this criterion for directing the focus away from the financial difficulties.³⁷⁰ Moreover, the high burden of proof placed on the parties might cause the criterion to be left unfulfilled.³⁷¹

In *BASF/Eurodiol/Pantochim* the Commission reformulated the third criterion which now holds, that “in the absence of a merger, the assets of the failing firm would inevitably exit the market”.³⁷² With the use of this criterion the Commission is interested in estimating whether the assets would stay in the market, be liquidated or be reallocated into other markets.³⁷³ As discussed above the Commission’s rationale adding this criterion was that the two first criteria are insufficient in completely ruling out that the assets of the failing company could not be acquired by third parties in the case of bankruptcy and return to the relevant market.³⁷⁴ This is a very demanding criterion to satisfy, partly because it is difficult for the parties to provide compelling evidence of the exit of the assets.³⁷⁵ In addition *Perpiñà* notes that whether, in fact, the division of the failing firm’s assets among competitors is *always* the less harmful scenario, is dependent on the structure of

³⁶⁸ Horizontal Merger Guidelines, para. 90.

³⁶⁹ Oinonen (2013), p. 9–10; OECD (2009), p. 184, 189; Malinauskaite (2012) p. 310. See also Baker & McKenzie (2009), p. 4.

³⁷⁰ Kaplan (1976) p. 648–649.

³⁷¹ As the target company is in financial ruins and its scarce resources are used to find potential buyers its financial turmoil might aggravate. *Perpiñà* (2015), p. 106–107; Bavasso & Lindsay (2007), p. 192.

³⁷² Guidelines, para. 90. See also *BASF/Eurodiol/Pantochim* (see supra note 12).

³⁷³ OECD (2009), p. 32.

³⁷⁴ *BASF/Eurodiol/Pantochim* (see supra note 12), para. 141. See also OECD (2009), p. 184; Kyprianides (2012), p. 579; Bavasso & Lindsay (2007), p. 186.

³⁷⁵ Oinonen (2013), notes that this criterion most often forms the obstacle for approving the defence, p. 11.

competition on the market.³⁷⁶ It should be noted that the inclusion of this criterion has followed from theoretical contributions regarding the defence, and academics, such as *Campbell*, who have emphasised the importance of the overall capacity in the appraisal of the defence.

Although the inclusion of the failing firm criteria into the Horizontal Merger Guidelines brought transparency as to how the Commission is estimating the failing firm defence the relationship between the criteria and the “lack of causality” requirement was not completely clarified. The question whether the fulfilment of these three criteria – originally introduced in *Kali and Salz*, reformulated in *BASF/Eurodiol/Pantochim* and now expressed in paragraph 90 of the Horizontal Merger Guidelines – is sufficient in order for the Commission to accept an anti-competitive merger on the basis of the failing firm defence continued to be debated. More precisely, which is the more important factor, meeting these criteria or fulfilling the *basic requirement*, now expressed in paragraph 89 of the Guidelines: “The basic requirement is that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger”. Or do rescue mergers have to satisfy both the basic requirement and the formal criteria?³⁷⁷

Kokkoris is confident that if a concentration is able to meet the formal criteria, it should be proclaimed compatible with the common market as the Commission uses these criteria to assess whether there is a lack of causality between the transaction and deterioration of competition.³⁷⁸ It seems that this thinking has been embraced in US merger control, as there the approval of the failing firm defence depends on whether the formal criteria is met, as the fulfilment of the criteria will in itself assure that the assets of the target company will remain in the market.³⁷⁹

Paredes describes this as an *absolute approach*, and criticises it for the production of Type I (blocking a pro-competitive merger) and Type II (approving an anti-competitive merger) errors in US merger control. While the focus on the fulfilment of the formal criteria is easy to administrate because of its simplicity and cost-efficiency, it ignores market realities and

³⁷⁶ Perpiñà (2015), p. 107. See also Decision of Kilpailu- ja kuluttajavirasto of 11 April 2016 in *Ruokakesko Oy / Suomen Lähikauppa Oy*, where the NCA assessed that Kesko’s acquisition of Lähikauppa was a more favorable end result in terms of competition when compared with the scenario where the assets of Lähikauppa would have been divided among the remaining competitors as the market leader S-ryhmä would have been able to further increase its market share in the already concentrated market, paras. 231–234.

³⁷⁷ Malinauskaite (2012) interprets so and is critical for the overly difficult conditions set for the failing firm defence to satisfy, p. 313. See also Kyprianides (2012).

³⁷⁸ Kokkoris (2006), p. 496. See also Komninou & Jeram (2014), p. 612.

³⁷⁹ Oinonen (2013), p. 7.

the actual effects that the merger, or the exit of the failing firm in question, is going to have on competition which should be the sole concern in merger control. These effects can only be taken into account through a case-by-case assessment.³⁸⁰

Perpiñà agrees as he fears that mergers could be blocked or remedied also in the EU for not fulfilling the formal criteria, even if its approval would be the least anti-competitive solution. According to him, the appraisal of rescue mergers should be based on counterfactual analysis where the alternative scenarios are defined with time and effort. This would be compatible with the Commission's more effects-based approach, as the circumstances of each specific case could be taken into account.³⁸¹

The Commission itself has noted that the “lack of causality between the merger and any worsening of competitive conditions is at the heart of the analysis”, and that “while especially relevant”, the formal criteria listed in paragraph 90 of the Horizontal Merger Guidelines “are not exclusive and exhaustive in establishing that a merging party is a failing firm”.³⁸² *Oinonen* interprets this so that while the formal criteria might offer the merging parties “pedagogical value and predictability” in the sense that they can estimate the successfulness of possible failing firm arguments, the failing firm defence can be accepted even when the formal criteria is not met if the basic criterion is fulfilled. He goes a step further by stating, that it also means that even if a merger met all the conditions in paragraph 90, it should not be automatically accepted if it does not fulfil the basic requirement.³⁸³

Oinonen's argument is convincing, as in *BASF/Eurodiol/Pantochom* the Commission considered the counterfactual scenarios to the merger after already establishing that the formal failing firm criteria were met. Most scholars seem to agree that the Commission's approach endorsing the counterfactual analysis is reasonable. Although it may cause ambiguities in terms of legal certainty, it is the only way that the Commission is able to avoid turning the failing firm defence formalistic (or absolute) in which case the Type I and Type II errors *Paredes* is warning about would follow.

³⁸⁰ *Paredes* (1996), p. 372–378. See also *Oinonen* (2013) who believes that the EU approach is fairly similar to what *Paredes* is suggesting.

³⁸¹ *Perpiñà* (2015), p. 105, 108

³⁸² OECD (2009), p. 183.

³⁸³ *Oinonen* (2013), however, notes that the predictability is suffering when the substantive appraisal is performed against the counterfactual and not the fulfilment of the formal criteria, p. 13–14, 17, 20.

The formal criteria have not turned irrelevant even though the European Commission has approved mergers purely on the basis of counterfactual analysis. It seems that the Commission still uses these criteria to assess whether the basic criterion is fulfilled as *Kokkoris* suggest. However, it could be argued that the Commission is not willing to limit its options even if one or more of the formal criteria fails to be met. Rather, it seems that the Commission has embraced a more effects-based approach with the use of counterfactual analysis and is considering whether the approval of the merger is actually more beneficial in terms of competition than its blocking.

4.3. Development of Defence in EU Merger Control during the Economic Crisis

It is well-known that the relevance of the failing firm defence increases during times of economic unease as firms are finding it difficult to acquire proper funding and are faced with the prospect of bankruptcy.³⁸⁴ The economic downturn may force companies to abandon their less profitable operations due to overcapacity on the market caused by the decreasing demand.³⁸⁵

However, the absence of more cases in which the parties would have successfully invoked the failing firm defence in front of the European Commission has led some to suspect that the conditions which the transaction must satisfy are very, if not even too, stringent.³⁸⁶ These opinions grew more vocal as the economic crisis continued to distress European companies and the Commission became faced with increased pressure to amend its rules so that they would better respond to economic realities. This thinking included the idea that merger control and the Commission's interpretation of the failing firm defence could be more lenient during an economic crisis.³⁸⁷ A more lenient approach could also be seen compatible with the welfare of consumers who would benefit in the long run from companies entering and intensifying competition in markets from which they could also exit if the financial crisis was forcing them to do so.³⁸⁸

³⁸⁴ See e.g. Malinauskaite (2012), p. 311.

³⁸⁵ Baker & McKenzie (2009), p. 3–5.

³⁸⁶ Malinauskaite (2012), p. 315; Kyprianides (2012), p. 582; Bavasso & Lindsay (2007) p. 181, 192. See also Baccaro (2004) according to whom the Commission had accepted the defence only in “nearly self-explanatory circumstances”, p. 11.

³⁸⁷ See e.g. Kokkoris (2014), p. 51–53; Malinauskaite (2012), p. 314; Lowe (2009), p. 22. Baccaro (2004), however, notes that the appraisal of failing firm defence is just as demanding in the United States apart from the failing division defence which has been accepted in the United States more leniently, p. 12.

³⁸⁸ Mason & Weeds (2012), p. 5. See also Kokkoris (2014) who notes that the Commission was able to accept the least harmful option and to loosen up its policy on state aid rules as European banks were in risk of drifting into a systemic crisis, p. 44. See also e.g. Nordström (2015) for a detailed discussion on this subject.

These demands have not received much sympathy from the European Commission, in fact, quite the opposite. The Commission has rejected the idea of a more lenient merger policy during an economic crisis noting that merging firms do not face a more severe test during economic booms either.³⁸⁹ The Commission believes that by resisting the pressure to ease its application of the Merger Regulation it has “set the foundation for a sustainable subsequent upturn”.³⁹⁰ Thus the Commission has continued to apply the existing merger control rules “while taking full account of the economic environment” maintaining that these rules “allow for all the necessary flexibility to deal with sometimes rapidly evolving market conditions”.³⁹¹ Taking into account wider considerations, such as employment concerns, has been ruled out by the Commission as they are better addressed through instruments aimed especially towards them.³⁹² Furthermore the Commission has stated that it has been able to take due notice of the dim market realities by “thoroughly analysing failing firm arguments”.³⁹³ This statement was based on the two decisions it took in the fall of 2013.

4.3.1. Nynas/Shell/Harburg Refinery: Failing Division Doctrine Disregarded

In early September of 2013 the third case in which the European Commission accepted a merger on the basis of the failing firm defence saw the light of day.³⁹⁴ The Commission cleared the concentration where Nynas acquired control over Shell’s Harburg Refinery on the basis that in the absence of the transaction the most likely scenario would have been the closure of the refinery assets which in turn would have led to higher prices for European consumers because of the significant reduction in the production capacity of the market.³⁹⁵

Shell Deutschland Oil, part of Shell group consisting of energy and petrochemical companies active throughout the production chain, wished to get rid of its fuels and distillates refinery and a base oil manufacturing plant in Harburg. Nynas – a global producer of naphthenic base, process oils, transformer oils and bitumen – intended to lease

³⁸⁹ OECD (2009), p. 187.

³⁹⁰ European Commission, *Commission Staff Working Document – Towards more effective EU merger control*, http://ec.europa.eu/competition/consultations/2013_merger_control/merger_control_en.pdf.

³⁹¹ European Commission, *Tackling the Financial Crisis*, http://ec.europa.eu/competition/recovery/financial_sector.html.

³⁹² Lowe (2009), p. 19.

³⁹³ European Commission, *Commission Staff Working Document – Towards more effective EU merger control*, http://ec.europa.eu/competition/consultations/2013_merger_control/merger_control_en.pdf.

³⁹⁴ In addition the Commission, however, has accepted mergers by not resorting to the failing firm defence on the basis of the counterfactual analysis as discussed in section 4.2.3.

³⁹⁵ European Commission, *Press Release Nynas/Shell/Harburg Refinery*, http://europa.eu/rapid/press-release_IP-13-804_en.htm.

the base oil manufacturing plant and parts of the refinery for 25 years although the agreement included an option enabling to convert this arrangement into an asset deal. Because of the lasting basis of control Nynas would have acquired over the Harburg refinery assets it had to be notified to the Commission.³⁹⁶

Because the relevant market was operated only by a limited set of competitors the transaction raised concerns as to its compatibility with the common market. However, unlike in other cases where the Commission had dealt with the failing firm defence discussed above, after a thorough definition of the relevant markets the Commission did not at any point of the decision conclude that the concentration would lead into Nynas having a dominant position in the markets and that it could be found incompatible with the common market. Instead after looking at the structure of competition as well as the development of supply and demand in each relevant market the Commission referred to the ECJ's judgement in *France and Others* and noted that the deterioration of competition must be caused by the concentration the evaluation of which requires the use of counterfactual analysis.³⁹⁷

Without a separate subheading called “failing firm defence” or “rescue merger” – or any mentioning of the parties failing firm arguments – as was the case in its previous decisions the Commission bluntly continued the build-up for its counterfactual analysis by referring to the formal failing firm criteria listed in paragraph 90 of the Horizontal Merger Guidelines which it was going to use in its assessment of the causal link.³⁹⁸

Compared to e.g. *Aegean/Olympic II* the Commission seemed able to conclude rather effortlessly that the failing firm criteria were met in the case at hand.³⁹⁹ The Commission became convinced by the economic evidence Shell had submitted that “it would be economically rational for Shell to close down the Harburg site” as continuing its operations would have been more costly. This together with the fact that Shell's decision to exit the market would be in line with its business strategy led the Commission to find it very likely that the Harburg refinery would be closed down and that the relevant assets would be

³⁹⁶ *Nynas/Shell/Harburg Refinery* (see supra note 16), paras. 2–14; European Commission, *Press Release Nynas/Shell/Harburg Refinery*, http://europa.eu/rapid/press-release_IP-13-804_en.htm.

³⁹⁷ *Nynas/Shell/Harburg Refinery* (see supra note 16), paras. 307–309.

³⁹⁸ *Ibid.* para. 310.

³⁹⁹ *Aegean/Olympic II* (see supra note 17).

forced out of the market “if not taken over by another undertaking, because of their poor financial performance and because of Shell's strategic focus on other activities”.⁴⁰⁰

Regarding the second criterion concerning an alternative purchaser Shell had shown that it had attempted to divest the Harburg refinery already during 2008–2010 without success. This enabled the Commission to find that the US Company Ergon was the only credible alternative purchaser of the Harburg refinery assets. Again Shell was able to show that it had in fact negotiated extensively with Ergon but these negotiations had ended without Ergon presenting a credible offer. After receiving the Commission’s SO outlining the potential concerns that arose from the transaction with Nynas Shell had even re-entered into negotiations with Ergon.⁴⁰¹ However, the Commission came to the conclusion that Ergon actually would not have been an alternative purchaser following a decision to deny the deal with Nynas as Ergon already had overcapacity in its production and it was not able to show continued strategic interest in acquiring the Harburg site. According to the Commission this meant that there was “no prospect of a less anti-competitive alternative purchase of the Harburg refinery assets” than the deal with Nynas.⁴⁰²

Effortless or not, the Commission did discuss the fulfilment of the first two failing firm criteria in some detail. As to the third criterion requiring the exit of assets of the failing company, however, the Commission simply found that the analysis of the first two conditions had shown that in the absence of the transaction Shell would most likely close down the refinery. As “rebuilding the Harburg refinery assets elsewhere would be prohibitively expensive and would take a very long time...the assets would most likely exit the market”.⁴⁰³ Thus all the formal failing firm criteria were considered to be met.

It was only after concluding this that the Commission moved on to look at the impact the concentration was going to have in the relevant markets. This technique enabled the Commission to conclude that significant impediment to competition was not going to take place as compared to the scenario where Harburg refinery assets would exit the market the concentration was in fact preserving the existing production capacity and lower price level in the naphthenic and transformer oils market. The concentration was cleared on the basis of this counterfactual logic which had shown that “in the absence of the notified transaction, the Harburg refinery assets will most likely exit the market, which would be

⁴⁰⁰ *Nynas/Shell/Harburg Refinery* (see supra note 16), paras. 314, 317–318, 327.

⁴⁰¹ *Ibid.* paras. 330–333, 338–344.

⁴⁰² *Ibid.* paras. 345–360.

⁴⁰³ *Ibid.* para. 361.

much worse for the competitive structure of the relevant markets than the reasonably foreseeable effects of the concentration”.⁴⁰⁴

Many writers have, however, questioned the Commission’s assessment of the failing firm criteria. Especially the inconsistency regarding the importance given to the financial health of the parent company, which is related to first criterion, has been criticised. The reasons for not assessing Shell’s viability, while in the *Aegean/Olympic* cases (discussed below) Marfin’s economic condition was thoroughly analysed and it was regarded essential in relation to its willingness to continue funding its subsidiary, have not been presented by the Commission. It has been speculated whether the Commission’s different approach could have followed from motives related to industrial policy as the refinery was the last of its kind in Europe. If the Commission should have assessed this criterion stringently in the case at hand it is likely that the first failing criterion would not have been met as the non-profitability of the refinery, a relatively small asset would not have represented an obstacle to Shell, a global enterprise in good financial condition.⁴⁰⁵

In relation to the first failing firm criterion I find it peculiar that, unlike in the *Aegean/Olympic* cases, the Commission did not address the matter of failing *division* defence. This is surprising as the Harburg refinery was even more clearly definable as a failing division. In earlier decisions regarding failing divisions the Commission had strictly demanded that the closure of the division should not be simply a “management decision” following from the unfulfilled expectations regarding the subsidiary’s profitability.⁴⁰⁶ Now the Commission seemed to emphasise the strategic interests of the parent company in accepting the first criterion. Whether this was related to industrial policy or not it does seem to represent a change in the Commission’s approach towards failing division arguments.⁴⁰⁷

Moreover the fact that the “exit of assets” criterion was not dealt with in detail can be considered somewhat surprising. The logic according to which the third failing firm criterion is considered to be met on the basis that the two first criteria have been shown to

⁴⁰⁴ *Nynas/Shell/Harburg Refinery* (see supra note 16), paras. 475, 504, 525.

⁴⁰⁵ Komninos & Jeram (2014), p. 613; Perpiñà (2015), p. 116. See also Pouncey et al. (2014), p. 25.

⁴⁰⁶ See Commission decisions in *Bertelsmann* (see supra note 305) and *Rewe/Meinl* (see supra note 315).

⁴⁰⁷ This cannot be dismissed as a “one-off” as the Commission applied similar reasoning in *Aegean/Olympic II* (see supra note 17) discussed below.

be satisfied could place the relevance of a separate third criterion in jeopardy.⁴⁰⁸ The Commission had not in its previous cases come to such a conclusion.

In fact, the whole structure of the decision deviated from earlier decisional practice as the failing firm criteria was discussed in the midst of the competitive assessment before estimating the effects of the merger on the relevant markets. This saved the Commission from the trouble of justifying the acceptance of an anti-competitive merger as the negative aspects following from the concentration were not discussed in the decision. The Commission simply noted that the effects following from the acceptance of the merger were better in terms of competition compared to its denial. While this is compatible with the approach endorsing counterfactual analysis the deviation from earlier practice is left unexplained.

The only criterion the appraisal of which seemed to be compatible with earlier cases was the one concerning alternative purchasers. One could argue that this criterion was relatively easy to fulfil as Ergon was the only considerable alternative purchaser. However, the parties were able to show that extensive negotiations had taken place between Shell and Ergon and explain the reasons for their failure as demanded by the earlier decisional practice of the Commission.

4.3.2. Aegean/Olympic Saga and the Difficulty of Getting it Right

When the acquisition of Olympic Air (Olympic) by its competitor Aegean Air (Aegean) was unconditionally approved in October 2013, it became the first time that the European Commission changed its mind over the same transaction in EU merger control history. The companies had proposed a merger already in 2011 but had then failed to get the Commission's approval.⁴⁰⁹

Aegean Airlines had started operating in 1999 and through its continuous growth it had become the largest airline in Greece while Olympic Air was witnessing financial difficulties, already before the economic crisis and the former state-owned airline had been sold to an investment company, Marfin Investment Group, in the fall of 2009. Under new ownership Olympic Air started to narrow down its operations and to concentrate on

⁴⁰⁸ The third criterion was reformulated precisely because the two first criteria were considered unable to rule out the possibility that the failing firm's assets could return to the relevant market after its exit. In the Commission's defence, however, it should be pointed out that the assets were exceptionally clearly definable and their exit perhaps was fairly evident when the assessment of the two first criteria had shown that the assets were to be closed down and that no alternative buyers would have been interested in purchasing them.

⁴⁰⁹ *Olympic/Aegean Airlines* (supra note 167); Komninos & Jeram (2014), p. 605.

domestic flights.⁴¹⁰ Marfin, however, was not able to turn Olympic profitable and so merger talks between the two Greek airlines began which led into a notification in June 2010 to the Commission. After a Phase II investigation the Commission, however, decided to prohibit the merger as it would have resulted in “a quasi-monopoly on the Greek air transport market” leading to higher prices. In particular there were nine domestic routes on which the new entity would have acted as the only operator which according to the Commission would have led “to the elimination of actual competition” while entry of new competitors that would have started to operate on these routes was considered unlikely. Although the parties offered remedies including slot releases in Greek airports the Commission estimated that these would have not been sufficient to remove the competition concerns.⁴¹¹

Even though the parties did not invoke the failing firm defence explicitly the Commission found that their arguments dealt with the defence criteria and therefore decided to assess whether the transaction would have met the conditions of the defence.⁴¹² As a preliminary remark the Commission noted that Olympic was actually a single failing division of Marfin which itself was in good financial condition and its viability was not threatened by Olympic’s losses. However, whether the case concerned a failing firm or a failing division had “no bearing on the assessment by the Commission in this case.”⁴¹³

The Commission did not believe that Olympic would exit the market in the absence of the merger. It estimated that Marfin was capable of offering further financial support and could not withhold this assistance from its subsidiary because of the risk of damaging its reputation. The Commission also refused to accept that the market would have been too small for two operators. Furthermore Olympic had restructuring options at its disposal which could have turned the company profitable in the absence of the merger. Thus, the Commission concluded that the first failing firm condition was not shown to be met.⁴¹⁴ On hindsight, we are able to note that the Commission’s analysis was relying on a false conception of the Greek air transport market and the Greek economy in general. The

⁴¹⁰ Komninos & Jeram (2014), p. 606.

⁴¹¹ The Commission’s concerns were not unfounded as the two airlines controlled over 90 per cent of the Greek domestic airline market. *Olympic/Aegean Airlines* (see supra 167), paras. 511, 1692–1693, 2236–2238; European Commission, *Press Release Olympic/Aegean Airlines Decision*, http://europa.eu/rapid/press-release_IP-11-68_en.htm.

⁴¹² The decision thus removed doubts as to whether the Commission will analyse the application of the defence even in cases where the parties do not expressly invoke it. Komninos & Jeram (2014), p. 607.

⁴¹³ *Olympic/Aegean Airlines* (see supra 167), paras. 1986, 1988.

⁴¹⁴ *Ibid.* paras. 1998–1999, 2002, 2017–2019, 2035–2039, 2048, 2065, 2068–2070.

Commission expected the Greek economy and air traffic numbers to start growing in the following years but in reality the Greek GDP continued to decline rapidly which also decreased the demand for air passenger transport.⁴¹⁵

Regarding the second criterion the Commission held along the lines of earlier decisional practice that the parties had been unable to “identify the third parties with whom Marfin would have negotiated nor the reasons why the negotiations would have been unsuccessful” and dismissed the fulfilment of the criterion.⁴¹⁶ In relation to the third criterion the Commission assessed that the assets that were in risk of exiting the market were the Olympic brand and logo and Olympic Air's slot and bilateral rights. Similarly as it had held in *JCI/Fiamm* the Commission believed that these assets were likely to shortly return to the relevant market in the case of Olympics' liquidation. Therefore, the third criterion was interpreted to be unfulfilled.⁴¹⁷

In relation to the basic requirement demanding the lack of causality between the merger and the deterioration of the competitive structure the Commission did not perform a separate counterfactual analysis as it had done in *JCI/Fiamm*. Instead, following a line of earlier decisions which it had adopted after *Kali and Salz*, the Commission used its analysis of the three criteria to deduce that “the transaction would most likely deteriorate competition to a significant extent, well beyond the extent of the deterioration that could result were Olympic Air to exit the market”.⁴¹⁸

Although the Commission can be defended for being suspicious of failing firm claims when Marfin had acquired Olympic just nine months previously, and the formerly state-owned subsidiary was still getting accustomed to a new business model, the decision has been criticised especially after the Commission reached the exact opposite result in *Olympic/Aegean II*.⁴¹⁹ If the defence is turned down on the basis that the company has been under a new ownership for only a limited period of time – or the defence is otherwise seen to be interpreted excessively strictly – investors might hesitate to enter new markets. This

⁴¹⁵ *Olympic/Aegean Airlines* (see supra 167), paras. 369, 377. Greek GDP decreased by 7,3 per cent in 2012 and by 5,8 per cent in 2013 while demand for domestic air passenger transport from Athens decreased by 26 per cent from 2009 to 2012. Komninos & Jeram (2014), p. 610. See also European Commission, *Press Release Aegean/Olympic II*, http://europa.eu/rapid/press-release_IP-13-927_en.htm.

⁴¹⁶ The Commission referred to its decision in *Bertelsmann* (see supra note 305) and the ECJ's decision in *France and Others* (see supra note 11) as it stressed the stringency of this criterion. *Olympic/Aegean Airlines* (see supra 167), paras. 2074–2075, 2086–2087.

⁴¹⁷ *Olympic/Aegean Airlines* (see supra 167), paras. 2089, 2105–2106, 2110–2111, 2118–2119. See also *JCI/Fiamm* (supra note 354), para. 809.

⁴¹⁸ *Olympic/Aegean Airlines* (see supra 167), paras. 1980, 2120.

⁴¹⁹ *Aegean/Olympic II* (supra note 17).

is the case especially with markets that can only accommodate a limited number of competitors as entering these markets is estimated to be risky and because the number of potential purchasers for failing businesses is limited. Thus in order to avoid the creation of unintended entry barriers investors should not be restricted to exit markets when they realise that they have made an unprofitable investment. Instead the theory of contestable markets suggests that investors should be able to trust that they can exit the market if losses are set to continue indefinitely. One can rightfully ask whether Marfin would have entered the Greek aviation market having known that it would not be able to sell Olympic to its only potential buyer. If companies halt from entering markets from which they might later have to retreat from the increased competition that their entry would have created is lost whereas fair recognition of the failing firm defence enables it to take place even if the market turns less competitive again after the approval of a rescue merger.⁴²⁰

Unlike in *Kali and Salz* the Commission refused to believe that the minimum efficient scale in the Greek aviation market would have demanded a (quasi-)monopoly market structure. According to the theory of contestable markets such a market structure is not problematic as new competitors will enter the market if the (quasi-)monopolist increases prices in the hope of monopoly profits.

Komninos and *Jeram* believe that the Commission's analysis failed because of its incorrect assessment of the Greek airline market. If the Commission had been able to predict the future development more accurately the failing firm argument might have had a better chance of succeeding.⁴²¹ According to *Perpiñà* the case highlighted the problems related to the use of formal failing firm criteria whereas a counterfactual analysis could have produced the correct decision the first time around.⁴²²

However, in 2013 as the Greek economy continued to decline the parties decided to give the merger another attempt which proved out to be successful.⁴²³ In addition to the economy in general, the circumstances regarding the parties themselves had changed drastically. Following cutbacks the turnovers of the parties had decreased to the extent that the concentration did not reach the turnover thresholds stipulated in Article 1 of the Merger

⁴²⁰ Komninos & Jeram (2014), p. 613–614; Mason & Weeds (2012), p. 5. See also Malinauskaite (2012), p. 312; Perpiñà (2015), p. 115.

⁴²¹ Komninos & Jeram (2014), p. 609.

⁴²² Perpiñà (2015), p. 113.

⁴²³ Komninos & Jeram (2014), note that the parties went through a long pre-notification before officially notifying their transaction, p. 609. It is possible that the parties received the initial go-ahead from the Commission during the pre-notification phase which encouraged them to give the merger another shot.

Regulation.⁴²⁴ Whereas in 2011 the parties had been competing on 17 routes from which the Commission had recognised competition concerns in nine, in 2013 there were overlaps only on seven routes from which the Commission assessed five to be problematic as there were no other competitors operating on those routes. However, maybe because of its earlier analysis of the market the Commission requested the Greek and Cyprian competition authorities to refer the case to it under Article 22(5) which the NCAs accepted.⁴²⁵

Although the economic circumstances had turned grimmer – and had thus paved the way for a more likely acceptance of the failing firm defence – the Commission did not request the referral of the case in order to accept it more leniently.⁴²⁶ The Commission launched a Phase II investigation on similar grounds as in *Olympic/Aegean Airlines*.⁴²⁷ It concluded its competitive assessment by stating that the transaction “would lead to a significant impediment of effective competition in particular as a result of the creation or strengthening of a dominant position” on the five routes in question as the competitive constraint exerted by the parties on each other would be removed.⁴²⁸ Although entry of competitors on Greek domestic routes was not assessed to be likely this time either the Commission now accepted that Olympic was, in fact, a failing company.⁴²⁹

The Commission began in its assessment regarding the defence by looking at the overall financial condition of Olympic and its parent company. This showed that “there can be little doubt” that Olympic had only survived “due to the continuous funding” of Marfin “and, more particularly, has not once been profitable since 2009 when Marfin re-launched

⁴²⁴ Aegean had cut down its domestic routes and reduced the size of its fleet from 32 to 28 aircrafts by the end of 2012. Olympic had ended its operations on almost all international routes while reducing its capacity on domestic flights by getting rid of its jets essentially turning into “a turboprop only airline”. Ibid. p. 610.

⁴²⁵ European Commission, *Press Release Aegean/Olympic II*, http://europa.eu/rapid/press-release_IP-13-927_en.htm; Komninos & Jeram (2014), p. 609.

⁴²⁶ In fact, the Commission’s analysis of the defence was as rigorous as ever. Komninos & Jeram (2014), p. 613; Perpiñà (2015), p. 114–115.

⁴²⁷ I.e. it suspected the creation of a quasi-monopoly on domestic routes which could increase consumer prices. Komninos & Jeram (2014), p. 609.

⁴²⁸ *Aegean/Olympic II* (supra note 17), para. 631.

⁴²⁹ Unlike in *NewsCorp/Telepiu*’ (supra note 335) the credibility of the failing firm argument was apparently not questioned by the Commission although the parties invoked the defence late during Phase II investigation. *Aegean/Olympic II* (supra note 17), paras. 630, 645, 838; European Commission, *Press Release Aegean/Olympic II*, http://europa.eu/rapid/press-release_IP-13-927_en.htm.

The Commission relied on Ryanair’s statements according to which the Irish airline had no intention of entering to the Greek domestic air travel market. Interestingly Ryanair announced that it was going to establish two new bases and three domestic routes (all of which were on the Commission’s list of problematic routes) in Greece three months after the approval of *Aegean/Olympic II*. This, of course, begs the question how much emphasis should actually be placed on the views of the competitors during a merger assessment. Komninos & Jeram (2014), p. 611, 615.

the company”. Furthermore the Commission noted that Marfin’s and its other subsidiaries’ financial condition had worsened radically over the last few years.⁴³⁰

The Commission continued to interpret that Olympic was a failing *division* of Marfin but this time went even further in stating that “the legal status of the failing business has been of limited importance for its classification as a failing firm or a failing division”.⁴³¹ However, it could be argued that the fact that Olympic was seen as Marfin’s subsidiary had an impact on the Commission’s *Aegean/Olympic* decisions as Marfin’s financial condition played a massive role on both occasions.⁴³² Indeed some would argue that Marfin’s financial condition was the only factor that had really changed during the course of time between the two notifications and it seemed to persuade the Commission to rethink its position on the matter.⁴³³ Even the Commission admitted that the classification of Olympic as a failing division formed a “part of first criterion of the failing firm analysis” which is why it appears misleading from the Commission to diminish the matter.⁴³⁴

Be that as it may the Commission seized the opportunity to further clarify its position on the matter of what constitutes a failing *division*. The Commission stated that the classification was not dependent on whether the failing entity in question was a legal person or not “but rather on the rationale behind the concept of failing division”.⁴³⁵ According to the Commission in the case at hand Olympic was seen to constitute a failing division as it was “sufficient to establish that Marfin would no longer be able to support Olympic”. Being classified as a failing division did not, however, require that Olympic would have endangered the viability of Marfin as this would have not corresponded to “the *rationale* underlying the failing firm analysis”, which concerned whether because of “the failure of the acquired company (and not necessarily of its parent)” the competitive structure would deteriorate also in the absent the merger.⁴³⁶

As the Commission moved on to discuss the failing firm criteria it first of all found that it seemed “very likely” that Olympic would have continued to need further funding from

⁴³⁰ *Aegean/Olympic II* (supra note 17), paras. 669–681.

⁴³¹ Ibid. paras. 685–686.

⁴³² Komninos and Jeram (2014), p. 608.

⁴³³ Perpiñà (2015), p. 114–115.

⁴³⁴ *Aegean/Olympic II* (supra note 17), para. 687.

⁴³⁵ Ibid. para. 686. I.e. the Commission was not interested in whether the failing entity was a separate subsidiary of a parent company as opposed to a mere business division.

⁴³⁶ Ibid. para. 687–689.

Marfin during the coming years.⁴³⁷ Compared to its previous estimate the Commission changed its opinion on whether Marfin was to be able to continue funding its loss making subsidiary. Furthermore even if Marfin would have been able to continue Olympic's funding, according to the Commission, it lacked the strategic interest to do so as "Marfin cannot indefinitely cover Olympic's losses if the airline has no prospects of profitability in the foreseeable future". Thus, the Commission found that the merger satisfied the first failing firm condition.⁴³⁸

The Commission also made a *complete* turnover regarding the second criterion establishing that there had been "only rather limited credible interest" in Olympic from alternative purchasers in the past.⁴³⁹ It is worth noting that the Commission came to this conclusion by looking at previous attempts to sell Olympic before Marfin had purchased the airline. This suggests that the Commission could have reached the same result regarding the second criterion already in *Olympic/Aegean Airlines*.⁴⁴⁰ Similarly the Commission's conclusion regarding the exit of Olympic's assets was turned upside down as its market investigation showed that "none of the responding 20 European airlines stated that they had any interest in acquiring the Olympic brand" and that "no third party substantiated an interest for taking over Olympic's bilateral traffic rights".⁴⁴¹

This time around the Commission included a separate section concerning counterfactual scenarios to its decision. Its analysis showed that although the transaction had anti-competitive effects – namely those following from a "monopoly on the five routes of concern" – these effects were "similar to those which would in any event occur" in the absence of the merger. Therefore, the Commission found that the proposed merger was not the cause of deterioration of competition and could be accepted unconditionally.⁴⁴²

Komninos and *Jeram* find it peculiar that the Commission chose to analyse the counterfactual scenarios as the competitive situation in the market was already assessed extensively while discussing the failing firm criteria. According to them in case the concentration meets the failing firm criteria, it is not necessary to study the anti-

⁴³⁷ Olympic had been making losses since the start of its operations in 2009 despite restructuring efforts and considerable financial support from Marfin. *Aegean/Olympic II* (supra note 17), paras. 700, 707, 736.

⁴³⁸ Ibid. paras. 740, 751, 764, 768, 804–805.

⁴³⁹ Ibid. para. 809.

⁴⁴⁰ *Olympic/Aegean Airlines* (supra note 167).

⁴⁴¹ *Aegean/Olympic II* (supra note 17), paras. 822, 825.

⁴⁴² Ibid. paras. 835–836, 839–841.

competitive effects any further since if the merger would not take place the failing firm would exit the market and there would not be any competition left between these firms.⁴⁴³

Although these writers otherwise produce well-rounded arguments about the *Aegean/Olympic* saga, I believe their opinion on this matter is incorrect. It is true that the Commission did not perform a separate counterfactual analysis in cases following its decision in *Kali and Salz* as the “causal link” was assessed with the help of the criteria in them. However, in *BASF/Eurodiol/Pantochim* and in the cases that followed this decision a separate counterfactual analysis was performed regardless of whether the criteria were fulfilled or not. I.e. the Commission was not solely relying on the criteria when assessing whether the merger was causing the deterioration of the competitive structure.

The counterfactual analysis is important both when the formal criteria is left unfulfilled as well as when the formal criteria is met in order to avoid the approval of anti-competitive mergers when there are more beneficial alternatives in terms of competition on display. The mere fact that the failing company would exit the market in the absence of the merger does not mean that competitive structure following from the approval of the merger would necessarily be better. Approving or denying a merger purely on the basis of the fulfilment of the formal failing firm criteria would lead into an *absolute* defence which is unsuited with the effects-based approach the Commission is otherwise pursuing.

The fact that the Commission changed its mind about the merger in two years favours the critics who have claimed that its interpretation of the failing firm defence has been too strict. Although the Commission justified the different outcomes by referring to the circumstances, which had changed considerably worse by 2013, it can be argued that the transaction should have been accepted already in 2011. The European Commission’s inability to accept that the Greek airline market was not any more sustainable for two companies in 2011, i.e. after the economic crash the *minimum efficient scale* demanded that the market is operated by a single airline, seems to suggest that the Commission was not willing to rely on the theory of contestable markets, which it had followed when accepting rescues merger. Instead other theories such as ordoliberalism and its notion of complete competition – fear of market structures where there is only a dominant company that is able to determine the market price on its own – seem to have gained the upper hand.

⁴⁴³ Komninos & Jeram (2014), p. 612.

On the other hand, one should note that competition authorities cannot review failing firm arguments too leniently as this could lead to the approval of anti-competitive mergers the restriction of which is more favourable in terms of competition. The failing firm defence presents a difficult test for competition authorities as finding the right balance between too harsh and overly lenient rescue merger test is not easy. The Commission has rightly regarded failing firm arguments with suspicion and assessed them rigorously. But *Olympic/Aegean Airlines* can be used as a reminder of what follows if passing the failing firm defence becomes unreasonably difficult: Type I errors where mergers that do not cause the deterioration of competition are blocked.

5. Conclusions

The aim of this thesis was to clarify, how have the decisions regarding the failing firm defence, which the European Commission adopted during the recent economic crisis, affected the failing firm defence doctrine that had been previously established in EU merger control. It can be argued, that the European Commission has followed a rather consistent effects-based approach while reviewing failing firm arguments invoked by merging parties. Ever since its initial approval of the defence in *Kali and Salz* the Commission has insisted that the defence should only be accepted when there is a *lack of causality* between the merger and the deterioration of the competitive structure following from it. Although the Commission has developed the (formal) failing firm criteria, which concentrations should *generally* meet in order to be accepted under the failing firm doctrine, these criteria were, according to my interpretation, only set for the assessment of this causality. This is how the Commission assessed the first cases that followed its *Kali and Salz* decision: as the *Kali and Salz* criteria were not met in any of them the Commission concluded that a causal link *did exist* between the concentrations and the anti-competitive effects following from them and decided to block them or require remedies from the merging entities.

However, the Commission's method of assessing the "causal link" placed the formal failing firm criteria at the centre of its analysis, which is probably why it has been interpreted that the satisfaction of these criteria was not just a tool to assess causality between mergers and deterioration of competition. Because of this, the later decisional practice of the Commission, in which it used counterfactual analysis to estimate whether there indeed existed a *causal link*, created confusion as to whether the parties invoking the defence were demanded to show, that their merger satisfied both the formal criteria and the "lack of causality" requirement, which was assessed through counterfactual analysis.

According to my understanding, the failing firm defence can be accepted in EU merger control purely on the basis of satisfying the "lack of causality" requirement as the formal criteria is used only as a tool to assess whether this basic requirement is fulfilled. In other words, the formal criteria do not need to be fulfilled for the defence to be accepted and, even though the formal criteria would be met, this does not guarantee the acceptance of the defence, as counterfactual analysis is needed to estimate whether the basic requirement is satisfied.

The cases, in which the Commission accepted the use of the failing firm defence during the economic crisis, did not bring a change to this founding principle of the doctrine. Despite the striking simultaneousness of the two cases they went through a very different type of appraisal process. Even though in *Nynas/Shell/Harburg Refinery* the Commission used the formal failing firm criteria in its assessment concerning the causal link between the merger and the deterioration of the competitive structure it never stated that the parties would have invoked the defence. Moreover this assessment was performed before the Commission had looked at the effects that the concentration would have on competition. The structure of the decision relieved the Commission from concluding that the transaction was anti-competitive as when compared with the effects following from the counterfactual scenario the approval of the concentration was seen to enable the preservation of aggregative output and lower market prices. In *Aegean/Olympic II* the lack of causality between the merger and the deterioration of the competitive structure was also shown through the fulfilment of the formal failing firm criteria and confirmed by looking at the counterfactual scenarios, which produced the same outcome. However, the structure of the decision represented a more traditional failing firm doctrine following the line of the *BASF/Eurodiol/Pantochim* decision. Both cases, however, were cleared on the basis that no causal link existed between the merger and the anti-competitive effects. This reaffirmed that the Commission is not following an absolute defence where the satisfaction of the formal criteria would be enough to clear the merger. In this respect the Commission's application has stayed unchanged.

The 2013 cases were important in restoring faith – that some already seemed to have given up – on the Commission's ability to clear mergers on the basis of the defence. Moreover, both cases seem to represent a more lenient approach towards the failing *division* doctrine. Whereas the Commission had in its earlier decisions demanded that the exit of the division should not be caused by a mere management decision of the parent company it was now willing to look at the *strategic incentives* of the parent companies to continue funding their loss-making subsidiaries. In *Nynas/Shell/Harburg Refinery* this was essential, as the outcome regarding the fulfilment of the first criterion would have turned out very different if the assessment had concerned Shell's financial condition. For some reason – industrial policy considerations have been suggested – the Commission did not perform such an assessment. The opposite was true for Marfin, the financial condition of which might have been the decisive factor for the Commission to reach an opposite conclusion compared to

its 2011 decision. But even in *Aegean/Olympic II* the strategic interests of Marfin were considered by the Commission unlike in previous cases concerning failing divisions.

Whether or not the economic crisis played a role in this change of practice is difficult to assess. The Commission may have simply realised that its earlier approach regarding the failing division defence was too demanding and could have reached the same conclusion similarly during a period of economic growth. Stringent application of the failing division defence will, according to the theory of contestable markets, lead to the creation of exit barriers and investors may become cautious about investing in markets from which exit is uncertain. The fact that the Commission refused to accept the merger of Aegean and Olympic in 2011, and performed a thorough competitive analysis also in 2013, goes to show that the Commission's assessment was not being affected by social considerations. Nevertheless, the crisis can be credited for causing so severe economic circumstances to European companies, that the Commission got the opportunity to further develop the failing firm doctrine on two occasions. Similarly during the economic crisis failing firm arguments were presented in mergers belonging to the jurisdiction of NCAs.⁴⁴⁴

The idea, that a merger can be accepted when anti-competitive effects are to follow even in the absence of the transaction, was created in US case law. However, even though being influenced by it, the application of the failing firm defence in EU merger control differs from the doctrine applied in the US in a few aspects. Unlike the Commission's decisional practice, the early US case law was not based on the comparison between the approval and the rejection of the defence and their effects on competition. Instead the initial approval of the defence in US case law was influenced by social considerations: as competition would reduce anyway following the inevitable exit of the failing firm the approval of an anti-competitive merger was used to further employment and the interests of shareholders who would have suffered from the bankruptcy. No comparison was performed as to whether the exit of the failing company could actually be followed by a more pro-competitive outcome, e.g. the division of the failing company's assets between smaller competitors in the market. The European Commission has refused to let such social considerations to have an effect on its decisions regarding rescue mergers.

⁴⁴⁴ See e.g. *Ruokakesko Oy / Suomen Lähikauppa Oy* (supra note 376) and the Decision of Konkurrensverket of 24 October 2011 *Arla Foods/Milko*.

Although the formal criteria for the acceptance of the failing firm defence was also set in US merger control its application has been different. Whereas the Commission has not considered that the non-fulfilment of the formal criteria would be a reason to automatically dismiss rescue merger claims and on the other hand has performed a counterfactual analysis even when the formal criteria has been met, the US approach has been described more formalistic or absolute: the approval of the defence is dependent on the satisfaction of the formal criteria.

The differences between the two jurisdictions are at least partly explainable through the eras under which the failing firm defence developed in them. Whereas early US case law was still mostly dealing with the notions of neoclassical economics the European Commission has had the privilege to lean on more modern schools of thought while developing its failing firm doctrine. Moreover the European Commission has been able to learn from the “mistakes” made on the other side of the Atlantic, as the defence was extensively debated – primarily in US – legal literature before being ever invoked in Europe. During this debate the failing firm defence developed into having a more economic basis which the European Commission was able to adopt early on. This basis was also compatible with the effects-based approach which the Commission otherwise did not adopt until the 2004 Merger Regulation. Thus the fact that the Commission adopted such an approach towards the failing firm defence already during the 1990’s under the dominance test can be considered remarkable.

In merger cases intervention by the European Commission is based on the theories of competitive harm. However, EU merger control and the Commission’s failing firm doctrine seem to have been influenced by a variety of theories discussed above. The Commission uses the notion of market power to deduce whether concentrations raise serious doubts as suggested by neoclassical economics. Harvard School possibly had an impact on the creation of EU merger control, as during its most influential period the Commission seemed become interested in monitoring market transactions and use the competition law provisions of the Treaty of Rome to do this. EU merger control still uses market structure and market concentration as a starting point in its appraisal process. However, Harvard School theories concerning market concentration would not allow rescue mergers to take place, which is why it has not had much of an influence on the application of the failing firm defence in EU merger control.

Chicago School together with its notion of economic efficiencies influenced the debate in legal literature concerning the failing firm defence after which the defence developed into having a more economically sound reasoning. This undoubtedly has had an impact on the development of the effects-based failing firm doctrine of the European Commission. However, the Commission's merger control is said to have been hostile towards efficiency claims before the adoption of the current Merger Regulation and moreover EU competition policy's consumer welfare goal is at odds with the total welfare model favoured by Chicago School. Hence, EU merger control has not embraced Chicago School's thinking at large.

The theory of contestable markets seems to have been especially influential in the European Commission's decisions in which the failing firm defence has been accepted. The Commission decisions to approve monopoly market structures on the basis of the failing firm defence in *Kali and Salz* and in *BASF/Eurodiol/Pantochim* are compatible with the theory. The same holds true for the recent amendment in the assessment of the failing division defence: parent companies can exit markets, which are not at the core of their strategies, when their investments prove unprofitable.

Freiburg School and ordoliberalism, although unquestionably important in the development of EU competition law, do not seem to have played a central role in the creation of the Commission's failing firm doctrine. This is not surprising when considering that ordoliberalism and its goal of complete competition reject monopolistic market structures. On the other hand, their influence might explain why the European Commission has been difficult at times to be persuaded by failing firm and especially by failing division arguments.